Supreme Court of the United States

OCTOBER TERM, 1958

No. 579

UNITED STATES, PETITIONER,

vs.

DURHAM LUMBER CO., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

INDEX

	Original	Print
Proceedings in the U.S.C.A. for the Fourth Circuit		
Appendices to brief of claimant-appellant consisting of record from the U.S.D.C. for the Middle District of North Carolina, at Greensboro	1	1
Appendix "A"—	2	1
Excerpts from Internal Revenue Code of 1954	2	1
Excerpts from General Statutes of North Carolina, (recompiled 1950)	3	2
Appendix "B"—	7	6
Minutes of the final meeting of creditors	7	6
Certificate by Referee to Judge	12	11
Memorandum opinion, Hayes, J.	15	13
Notice of appeal	17	15
Appendices to brief of claimant-appellees consisting of record from the U.S.D.C. for the Middle District of North Carolina, at Greensboro	19	16
Appendix "A"—Excerpts from General Statutes of North Carolina 1943 (as amended and recompiled) G.S. 44	20	16

	Original	Print
Appendix "B"—Excerpts from proceedings in the Superior Court for Durham County, North Carolina	22	18
Order granting leave to file a supplemental answer and bill of interpleader	22	18
Judgment	24a	20
Docket entries	25	28
Minute entry of argument and submission (omitted in printing)	26	29
Opinion, Haynsworth, J.	27	30
Judgment	39	39
Clerk's certificate (omitted in printing)	40	40
Order extending time to file petition for writ of certiorari	41	41
Order allowing certiorari	42	42

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[fol. 1] **IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT**

UNITED STATES OF AMERICA, PETITIONER

v.

DURHAM LUMBER COMPANY, a Corporation, and GEORGE H. CARTER, JR., Formerly Trading as DIXIE CONCRETE AND SUPPLY COMPANY

APPENDICES TO BRIEF FOR THE CLAIMANT-APPELLANT

[fol. 2] IN UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA, AT GREENSBORO

APPENDIX A

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 1952 ed., Supp. II, Sec. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, and the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 1952 ed., Supp. II, Sec. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under State or Territorial Laws*—In the office designated by the law of the State or Territory in which property subject to the lien is situated, whenever the State or Territory has by
[fol. 3] law designated an office within the State or Territory for the filing of such notice; or

(2) *With Clerk of District Court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; * * *

* * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 6323.)

General Statutes of North Carolina (Recompiled 1950):

SEC. 44-1. On buildings and property, real and personal.—Every building built, rebuilt, repaired or improved, together with the necessary lots on which such building is situated, and every lot, farm, or vessel, or any kind of property, real or personal, not herein enumerated, shall be subject to a lien for the payment of all debts contracted for work done on the same, or material furnished.

SEC. 44-6. Lien given subcontractors, etc., on real estate.—All subcontractors and laborers who are employed to furnish or who do furnish labor or material for the building, repairing or altering any house or other improvement on real estate, have a lien on said house and real estate for the amount of such labor

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done or material furnished, which lien shall be preferred to the mechanic's lien now provided by law, when notice thereof shall be given as hereinafter provided, which may be enforced as other liens in this chapter, except where it is otherwise provided; but the sum total of all the liens due subcontractors and [fol. 4] materialmen shall not exceed the amount due the original contractor at the time of notice given.

Sec. 44-8. Statement of contractor's indebtedness to be furnished to owner; effect.—When any contractor, architect or other person makes a contract for building, altering or repairing any building or vessel, or for the construction or repair of a railroad, with the owner thereof, it is his duty to furnish to the owner or his agent, before receiving any part of the contract price, as it may become due, an itemized statement of the amount owing to any laborer, mechanic, or artisan employed by such contractor, architect or other person, or to any person for materials furnished, and upon delivery to the owner or his agent of the itemized statement aforesaid, it is the duty of the owner to retain from the money then due the contractor a sum not exceeding the price contracted for, which will be sufficient to pay such laborer, artisan or mechanic for labor done, or such person for material furnished, which said amount the owner shall pay directly to the laborer, mechanic, artisan or person furnishing materials. The owner may retain in his hands until the contract is completed such sum as may have been agreed on between him and the contractor, architect or other person employing laborers, as a guaranty for the faithful performance of the contract by such contractor. When such contract has been performed by the contractor such fund reserved as a guaranty shall be liable to the payment of the sum due the laborer, mechanic or artisan for labor done, or the person furnishing the materials as hereinbefore provided.

Sec. 44-9. Subcontractors, laborers and materialmen may notify owner of claim; effect.—Any subcontractor, laborer, mechanic, artisan, or person fur-

[fol. 5] nishing materials, who claims the lien provided for in this article for labor on, or materials furnished for, any building, vessel, railroad, or real estate, may give notice to the owner, agent or lessee who makes the contract for the labor or materials, of the amount due by the contractor to such claimant. The notice shall be in the form of an itemized statement of the amount due, except where the contract is entire for a gross sum and cannot be itemized. Upon the delivery of the notice to the owner, agent, or lessee, the claimant is entitled to all the liens and benefits conferred by law in as full a manner as though the statement were furnished by the contractor. If the said owner, agent or lessee refuses or neglects to retain, out of the amount due the contractor under the contract a sum not exceeding the price contracted for which will be sufficient to pay such claimant, then the claimant may proceed to enforce his lien, and after such notice is given no payment to the contractor shall be a credit on or a discharge of the lien herein provided for.

SEC. 44-38. Claim of lien to be filed; place of filing. —All claims against personal property, of two hundred dollars and under, may be filed in the office of the nearest justice of the peace; if over two hundred dollars or against any real estate or interest therein, in the office of the superior court clerk in any county where the labor has been performed or the materials furnished; but all claims shall be filed in detail, specifying the materials furnished or labor performed, and the time thereof. If the parties interested make a special contract for such labor performed, or if such material and labor are specified in writing, in such cases it shall be decided agreeably to the terms of the contract, provided the terms of such

[fol. 6] contract do not affect the lien for such labor performed or materials furnished.

SEC. 44-43. Action to enforce lien.—Action to enforce the lien created must be commenced in the court of a justice of the peace, and in the superior court,

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according to the jurisdiction thereof, within six months from the date of filing the notice of the lien. But if the debt is not due within six months, but becomes due within twelve months, suit may be brought or other proceedings instituted to enforce the lien in thirty days after it is due.

[fol. 7] IN THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA

APPENDIX B

In Bankruptcy No. 1918

IN THE MATTER OF AUBREY H. MICHAEL & EDWARD L. EMBREE, JR., IND. AND T/A MICHAEL & EMBREE, CONTRACTORS

MINUTES OF THE FINAL MEETING OF CREDITORS

Bankrupt:

The final creditors meeting in the above case was duly held at the time and place as designated in the Notice to Creditors at which time there were present the Referee, the Trustee and interested parties.

The Report of the Trustee was made available for the inspection and examination of the creditors and there were no objections made to said report.

The following fees and expenses were found to be fair and reasonable and approved and directed to be paid as follows:

Herman A. Smith, U. S. Clerk costs as per separate order	$	718.48
W. Hance Hofler, Trustee's fee	$	461.29
....., Trustee's expenses	$	.....
Daniel K. Edwards (This includes $1,200.00 allocated in the lien order), Attorney for Trustee, fee	$	3,000.00
Expense of Trustee's Attorney	$	.....
Rufus W. Reynolds, advanced for telephone calls	$	7.88
Rufus W. Reynolds, travel expenses advanced	$	.....
E. K. Powe, Attorney for Bankrupt, fee	$	400.00
Daniel K. Edwards, Attorney for Petitioning Creditors, fee	$	200.00
....., Attorney for Petitioning Creditors, expenses	$	.....
Bank of Greensboro, N. C. Intangible tax for current year	$	10.41
Office Service Company, Preparing notices, etc. for Referee, special work	$	6.10
Charles W. White, State Receiver	$	300.00
Total	$	5,104.16

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[fol. 8] It appeared that there was a balance on hand of..... $13,884.91
After paying the above expenses there will be a balance of.. $ 8,780.75
to be applied as far as it will go in the following order:

Wages as follows:		
Pfd. Claim No. 10 J. W. Thames	$200.00	
Pfd. Claim No. 11 J. W. Thames	52.84	
		252.84
Adams Concrete Company	135.00	
Nolan Company	330.65	
(arising out of obtaining judgment against McArthur & Chambers, see order below)		465.65
Director of Internal Revenue—lien as filed in Durham County, on Nov. 2, 1954		4,017.53
Director of Internal Revenue—withholding and FICA assessment date Nov. 22, 1954—lien (not filed in Durham County)		3,254.73

Material Claims Which are Liens on Chambers-McArthur Judgment after Director of Internal Revenue Lien

Claimant	Amt. of Claim	20% Dividend	
Durham Brazing & Welding Company	360.78	14.68	
Dixie Concrete & Supply Company	3,088.54	639.36	
Durham Lumber Company	364.93	75.96	
	3,816.25		790.00
			$8,780.75

ORDER

Upon the petition of certain material furnishers and the claims by the Director of Internal Revenue, and after hearing the evidence, the argument of counsel, and consideration of briefs, the following facts and conclusions of law are made:

1

The bankrupts were general contractors doing business in and around Durham, North Carolina. They filed a voluntary petition in bankruptcy on January 3, 1955, and were adjudicated bankrupts on January 18, 1955.

2

That during the first part of 1954 the bankrupts entered into a contract to build certain camp buildings for G. T. McArthur and R. L. Chambers, hereinafter

[fol. 9] referred to as "Owners". The buildings were completed on July 15, 1954. At the date of bankruptcy there was an unpaid balance of $5250.00 due from the Owners to the bankrupts on the said contract. However, the Owners disputed the amount and contended that there was nothing due.

3

The Trustee instituted suit against the Owners in the Superior Court of Durham County, North Carolina, and finally won a jury verdict of $5250.00. The judgment on the verdict was entered on June 7, 1956. Shortly after the judgment was rendered the owners petitioned the bankrupt court for permission to pay certain material furnishers or subcontractors of the bankrupts who had given the owners notice of furnishing such material. At that time it appeared to the Owners that they had failed to include in the action or join as parties in the Trustee's action the alleged subcontractors of the bankrupt. Adams Concrete Company and Nolan and Company had already instituted suits against the Owners. These two suits were not combined with the Trustee's suit.

4

Extensive negotiations went on between the Trustee, the material furnishers and the Owners. Finally the Owners made a motion in the Superior Court to reopen the proceeding and make parties the alleged material furnishers. Nolan and Company filed a petition in the bankruptcy court for permission to make the Trustee a party to its action. Finally in Superior Court in order to get the judgment and matters settled the Trustee marked out an agreement and obtained permission of the bankruptcy court to compromise and settle the Nolan claim in the original amount of $741.25 [fol. 10] for the sum of $300.00 plus $30.45 court costs, and settle the suit involving the Adams Concrete and Block Company which was in the original amount of $228.63 for $123.00 plus $10.00 court costs, with the understanding that this amount would be paid from the judgment collected from Chambers & McArthur. After this agreement was entered, then the Owners voluntarily

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paid the judgment in the amount of $5250.00 plus $250.00 interest. It was understood that the parties who might be entitled to this fund would be determined in the bankruptcy court the same as if they were in the Superior Court. The Director of Internal Revenue was never party to any of those three actions.

5

The Durham Brazing & Welding Company whose claim is in the amount of $360.70 gave notice to the Owners of its claim on June 20, 1955. The Dixie Concrete & Supply Company whose claim is $3,089.54, gave notice to the Owners on January 12, 1955. The Durham Lumber Company, whose claim is in the amount of $366.93, gave notice in February, 1955. The other subcontractors and material furnishers claiming a lien did not give any notice. They are as follows: Genn Hosiery Mill, $374.15; Gwalney Oil Company, $334.64; Lovett Electric Company, $437.50; Nello L. Teer Company, $355.07; Peedan Steel Company, $820.29.

6

The Director of Internal Revenue claims a lien on the amount collected from the Owners as well as a lien on the other assets of the bankrupts by reason of withholding and F. I. C. A. taxes assessed August 13, 1954, filed in the Register of Deeds Office of Durham County on the 2nd day of November, 1954, on which there is a present balance due of $4,017.53 and a tax claim for [fol. 11] withholding and F. I. C. A. assessed November 22, 1954, in the amount of $3254.73. The Trustee and his attorney spent several days in trying, arguing and collecting the judgment from the Owners. Reasonable compensation which the attorney for the Trustee earned is found to be $1200.00. The bankruptcy court costs on the amount recovered is 2%, and the Trustee's commission is 2%, making a total cost of $1420.00 which should be allocated and paid from the judgment. This allocation and expense is included in the above attorney's fee and Trustee's fee and court costs.

Conclusions of Law

7

The $135.00 compromise and agreement with Adams Concrete and Block Company and the $330.63 compromise with Nolan and Company was legal and necessary and was part of the costs of procuring the settlement and judgment and that this sum should be first taken from the amount of the judgment. After then deducting the costs of obtaining the judgment, the Director of Internal Revenue has a lien prior to the liens as claimed by the Durham Brazing & Welding Company, Dixie Concrete and Supply Company and the Durham Lumber Company which position is supported by the following cases:

U. S. v. The White Bear Brewing Co., 350 U. S. 1010 (1956)
U. S. v. Collatta (1955) 350 U. S. 800
U. S. v. Kings County Iron Works, Inc., (C.A. 2nd 1955) 224 Fed. 232
Brust v. Starr (C.A. 2nd 1956) 237 Fed. 2nd 135
United States v. England (C.A. 9th 1955) 226 Fed. 2nd 205
United States v. City of New Brittain (1953) 347 U. S. 81

8

[fol. 12] The material and subcontract claimants who did not file any notice with the Owners are not entitled to any liens on any proceeds of the judgment by reason of the fact that such notice must be given pursuant to the statutes of North Carolina before any lien is created or any right to any funds in the hands of the Owners is established.

Wherefore, It Is Ordered that after the application of the balance of the funds on hand to the lien by the Director of Internal Revenue, the unpaid balance of the liens as above computed in the minutes of the final creditors meeting be paid from the judgment from McArthur & Chambers and that the remainder after deducting the said liens by the Director of Internal Revenue be paid prorata on the claims of Durham Brazing & Welding Company, Dixie Concrete & Supply Company, and Durham Lumber Company as above indicated.

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IT IS FURTHER ORDERED that the claimants as subcontractors and material furnishers who did not file any notice with the Owners are not entitled to any liens on any of the proceeds.

This the 22 day of August, 1957.

(S.) RUFUS W. REYNOLDS,
Referee in Bankruptcy.

• • • •

CERTIFICATE BY REFEREE TO JUDGE

I, Rufus W. Reynolds, Referee of said Court, do hereby certify that in the course of proceeding in the said cause [fol. 13] before me, upon the hearing of claims of liens by material furnishers and subcontractors of the Bankrupt and the Director of Internal Revenue as to the amount, validity and priority, the following question was presented:

> "Where Trustee for general contractors recovers balance due on construction contracts and the Director of Internal Revenue assesses taxes against the Bankrupt before bankruptcy and before subcontractors of the Bankrupt give notice of lien to Owners, who has prior lien, Director of Internal Revenue or subcontractors?"

Upon considering the evidence I made findings as set out in the order as attached hereto. Said findings were made after considering the testimony, documentary evidence and argument of counsel.

WHEREUPON, on the 22nd day of August, 1957, I entered an order allowing the lien by the Director of Internal Revenue Senior to the subcontractors' liens, first satisfying the Director's liens from other assets in the bankrupts' estate.

WHEREUPON, petitions for review of said order by the Judge were filed by George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company, and Durham Lumber Company.

Attached to this certificate are the following documents:

1. Petition for Review by George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company.
2. Petition for Review by Durham Lumber Company.
3. Petition by Chambers & McArthur to compromise judgment and apply payments on judgment.
4. Petition by Noland Company, Inc., to join Trustee as party in action.

[fol. 14] 5. Order approving compromise with Noland Company, Inc., and Adams Concrete Company.

6. Petition by Trustee to give material claimants notice to establish claims.
7. Order by Referee dated July 1, 1957, directing alleged material furnishers to establish liens.
8. Service of notice on alleged claim holders.
9. Notice to all creditors and alleged lien holders of hearing on claims for lien.
10. Proceedings of the action in State Court by Trustee against G. T. McArthur and R. L. Chambers.
11. Claims of liens as filed by:
    - (A) Durham Brazing and Welding Works
    - (B) Pedra Steel Company
    - (C) Lovette Electric Construction Company
    - (D) Nello L. Teer Company
    - (E) Durham Lumber Company
    - (F) George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company

12. Briefs as filed by:
    - (A) U. S. Treasury Department
    - (B) Durham Brazing and Welding Works

13. Letter from E. K. Powe, Attorney for the Bankrupt.
14. Letter from Daniel K. Edwards, Attorney for the Trustee.
15. Order entered by Referee, dated August 22, 1957, determining priority and amount of claim. (The order is combined with final distribution of funds on hand in order that a picture of the entire matter can be ascertained.)

This the 4 day of September, 1957.

(S.) Rufus W. Reynolds,
Referee in Bankruptcy.

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[fol. 15] MEMORANDUM OPINION—October 14, 1957

HAYES, District Judge:

Exceptions to the order of the Referee in Bankruptcy were filed by Geo. H. Carter, Jr. formerly trading as Dixie Concrete and Supply Co., and Durham Lumber Co., in so far as the order gave the United States tax lien priority over them.

The Referee applied the doctrine of priority usually applicable to the distribution of assets belonging to the bankrupt and relied primarily on *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010, reversing 7th Circuit in 227 Fed. 2d 359. There the bankrupt was the owner of real property which had been improved by a person asserting a mechanic's lien. Priority of liens as between the United States and such a claimant for a mechanic's lien was the issue determined.

In the instant case the owner is not the bankrupt; the contractor is the bankrupt. It is therefore necessary to determine whether the asset in question was the sole property of the bankrupt before the *White Bear* case, *supra*, applies.

The contractor (bankrupt) agreed to furnish and pay for all labor and materials and erect the improvement for a stated sum, free from all liens against the property.

When the contractor was adjudged a bankrupt, the work had been completed and a balance was due the contractor if the labor and materialmen's liens were discharged.

The trustee sued the contractor and obtained a judgment for the balance of the contract price. However, the two excepting creditors gave the statutory notice to the owner of the amounts due them by the contractor for labor and materials furnished by them in the performance of the contract. They did all required of [fol. 16] them to establish a valid lien against the property of the owner—not the bankrupt contractor.

After the trustee obtained a judgment against the owner but before paying the judgment, the Superior Court, rendering the judgment, made an order, pursuant to the law of North Carolina, *Swiggins* v. *Buss Co.*, 230

N.C. 234, making these lien claimants parties to the original action. That court, with all the parties before it, required the defendant owner to pay over to the trustee the balance due, and transferred the liens to the fund and discharged the owner from their claims. The state court permitted the fund to come into the hands of the trustee impressed with such liens thereon as the claimants possessed, to be determined by the bankruptcy court. It was not provided in the order or implied in it, that the funds was an asset of the bankrupt free from the liens of these claimants.

Since the state court discharged the owner from these claims and transferred the liens to the funds, it follows that the fund in the possession of the trustee is subject to whatever valid liens existed at the time of the transfer. Under the law of North Carolina, where a laborer, materialman or subcontractor gives the required statutory notice to the owner his lien immediately attaches to any balance due by the owner to the original contractor, and payment to the contractor thereafter will not discharge the owner from the lien of such a claimant. The fund was required by the law of North Carolina to be applied first in discharge of these liens before it became an asset of the bankrupt contractor. *Schnepp* v. *Richardson*, et al., 222 N.C. 228; *Assurance Society* v. *Basnight* et al., 234 N.C. 347.

The usual order of distribution of the assets of a bankrupt undoubtedly controls the disposition of assets owned by the bankrupt but can not be enlarged to include assets not belonging to the bankrupt. *Fidelity and Deposit Co.* v. *New York City Housing Authority*, [fol. 17] 241 F. 2d 142 2d cir. 0. The exceptions are allowed and the order of the Referee is modified accordingly.

This the 14 day of October 1957.

(S.) JOHNSON J. HAYES,
United States District Judge.

Exception allowed to the United States October 14, 1957.

HAYES,
Judge.

* * * *

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NOTICE OF APPEAL

Notice is hereby given that the United States of America hereby appeals to the United States Court of Appeals for the Fourth Circuit from the Memorandum Opinion of Honorable Johnson J. Hayes dated October 14, 1957, modifying the order of the Referee and reversing the same insofar as said order of the Referee gave certain tax liens of the United States of America priority over the claims filed by George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company, Durham Lumber Company, and Durham Brazing and Welding Company.

(S.) ROBERT L. GAVIN,
United States Attorney,
314 Post Office Building,
Greensboro, North Carolina.

(S.) LAFAYETTE WILLIAMS,
Assistant United States Attorney.

• • • •

[fol. 19] **APPENDICES TO BRIEF FOR THE CLAIMANT-APPELLEES**

[fol. 20] IN UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA, AT GREENSBORO

APPENDIX A

General Statutes of North Carolina 1943 (as amended and recompiled) G.S. 44.

Sec. 44-10. *Sums due by statement to constitute lien.*

The sums due to the laborer, mechanic or artisan for labor done, or due the person furnishing materials, as shown in the itemized statement rendered to the owner, shall be a lien on the building, vessel, or railroad built, altered, or repaired, without any lien being filed before a Justice of the Peace or the Superior Court.

Sec. 44-11. *Where sums due contractor from owner insufficient payment pro rata.*

If the amount due the contractor by the owner is insufficient to pay in full the laborer, mechanic, or artisan, for his labor, and the person furnishing materials, for materials furnished, it is the duty of the owner to distribute the amount pro rata among the several claimants, as shown by the itemized statement furnished the owner, or of which notice has been given the owner by the claimant.

Sec. 44-12. *Contractor failing to furnish statement, or not applying owner's payments to laborer's claims, misdemeanor.*

If any contractor or architect shall fail to furnish to the owner an itemized statement of the sums due [fol. 21] to every one of the laborers, mechanics, or artisans employed by him, or the amount due for materials, before receiving any part of the contract price, he shall be guilty of a misdemeanor. If any

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contractor shall fail to apply the contract price paid him by the owner or his agent to the payment of bills for labor and material, he shall be guilty of a misdemeanor and upon conviction thereof shall be fined or imprisoned, or both, at the discretion of the court.

[fol. 22] APPENDIX B

IN THE SUPERIOR COURT
FOR DURHAM COUNTY,
NORTH CAROLINA

APRIL-MAY CIVIL TERM

W. HANCE HOFLER, TRUSTEE IN BANKRUPCY, FOR AUBREY H. MICHAEL AND EDWARD L. EMBREE, JR., INDIVIDUALLY, AND TRADING AS MICHAEL & EMBREE, CONTRACTORS

v.

G. T. MCARTHUR AND R. L. CHAMBERS, ORIGINAL DEFENDANTS, AND GEORGE H. CARTER, JR., TRADING AS THE DIXIE CONCRETE SUPPLY COMPANY; DURHAM LUMBER COMPANY, ET ALS.

ORDER

THIS MATTER coming on to be heard upon the written verified Motion of the defendants, G. T. McArthur and R. L. Chambers, for leave to file a Supplemental Answer and Bill of Interpleader and to make certain persons, firms, and corporations additional parties defendant in this action, and the said Motion having been duly and carefully considered and the Court being of the opinion that the said defendants, McArthur and Chambers, are entitled to file a Supplemental Answer and Bill of Interpleader and to have said persons made additional parties defendant in this action; it is now, therefore,

ORDERED that the said G. T. McArthur and R. L. [fol. 23] Chambers be and they are hereby permitted and granted leave to file a Supplemental Answer and Bill of Interpleader in this matter; and it is

FURTHER ORDERED that George H. Carter, Jr., trading as the Dixie Concrete Supply Company; Durham Lumber Company, Incorporated; Durham Brazing & Welding Works; Gann Hosiery Mills, Inc. Noland

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Company, Incorporated; R. D. Adams, F. H. Adams, P. F. Adams, Jr., and J. D. Adams, trading and doing business as Adams Concrete Products Company; J. R. Bagwell Company, a corporation; C. V. Brown and W. L. Brown, Jr., trading as Brown Brothers Plumbing & Heating Company; Carolina Block Company; Carolina Steel & Iron Company, a corporation; W. B. Connelly; Cowan & Mitchell Lumber Company, a corporation; Cowan Construction Co., Inc., L. H. Mount, Receiver for Cowan Construction Co., Inc.; Lovette Electric Construction Company, a corporation; Peden Steel Company, a corporation; Arthur F. Perkins, Jr., trading as Perkins Glass Company; Public Hardware, Incorporated; Nello L. Teer Company, Inc.; Walton Roofing & Heating Company, Incorporated; Morgan Lee; Coley Laws; Hydra S. Best, trading as Best Plumbing Company; Fuquay-Varina Builders Supply; D. W. Jackson; and E. G. Belvin, Sheriff of Durham County, be and they are hereby made additional parties defendant in this action; and Summons will issue for said additional defendants from the Office of the Clerk of the Superior Court of Durham County; and it is

[fol. 24] FURTHER ORDERED that a copy of the Supplemental Answer and Bill of Interpleader be served along with the Summons on each of the said additional defendants and that a copy of the Motion and Order likewise be served upon said additional defendants, and that they be required to answer the Supplemental Answer and Bill or Interpleader within thirty (30) days after service thereof, or the relief prayed for will be granted.

This the 3rd day of May, 1957.

(signed) CLAWSON L. WILLIAMS
Judge Presiding Over The Superior Court of Durham County

[fol. 24a] IN THE SUPERIOR COURT FOR DURHAM COUNTY, NORTH CAROLINA

APRIL-MAY CIVIL TERM

FOURTEENTH JUDICIAL DISTRICT

W. HANCE HOFLER, TRUSTEE IN BANKRUPTCY FOR AUBREY H. MICHAEL AND EDWARD L. EMBREE, JR., INDIVIDUALLY, AND TRADING AS MICHAEL & EMBREE, CONTRACTORS

v.

G. T. MCARTHUR AND R. L. CHAMBERS, ORIGINAL DEFENDANTS, AND GEORGE H. CARTER, JR., TRADING AS THE DIXIE CONCRETE SUPPLY COMPANY; DURHAM LUMBER COMPANY, INC., ET AL.

JUDGMENT—May 22, 1957

THIS CAUSE coming on to be heard before His Honor Clawson L. Williams, Judge Presiding over the Superior Court for the Fourteenth Judicial District at Durham, and being heard upon the return of the order to show cause entered in this case by the undersigned Clawson L. Williams, Judge Presiding over and holding the Courts for the Fourteenth Judicial District on the 3rd day of May, 1957 which Order to show cause was returnable before the undersigned at the Court House in Durham on the 20th day of May, 1957, at 2:30 o'clock, P. M.; and it appearing to the Court that pursuant to the said Order to show cause the matter did come on for hearing and was heard on this the 20th day of May, 1957, at 2:30 o'clock, P. M., at the Court House in Durham, where and when there were present Daniel K. Edwards, Esq., attorney for the plaintiff in this action; A. L. Purrington, Jr., Esq., attorney for Interpleaded Defendant, Noland Company, Inc., J. W. Bailey, Jr., attorney for Interpleaded Defendant, Peden Steel Co., Arthur Vann, Esq., attorney for Interpleaded Defendant, George H. Carter, Jr., trading as the Dixie Concrete Supply

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Company, Claude V. Jones, Esq., attorney for the Original Defendants, G. T. McArthur and R. L. Chambers, and G. T. McArthur and R. L. Chambers, in person; and it appearing to the Court that the Plaintiff filed a written Motion to strike out and dismiss the Supplemental Answer and Bill of Interpleader filed by the Original Defendants, G. T. McArthur and R. L. Chambers, and George H. Carter, Jr., trading as Dixie Concrete Supply Company and Carolina Steel & Iron Co., filed written Answers to the Supplemental Answer and Bill of Interpleader as appear in the record; and this matter having been heard before the undersigned upon the supplemental [fol. 24b] answer and bill of Interpleader, treated as an affidavit, and upon the Answers filed and arguments of counsel; and after fully hearing and considering the pleadings, and admissions and arguments of counsel the Court finds:

1. That the defendant, G. T. McArthur and R. L. Chambers, entered into a written Contract with Aubrey H. Michael and Edward L. Embree, Jr., individually, and trading as Michael & Embree, Contractors, under date of May 7, 1954, by the terms of which contract the said Michael & Embree agreed to furnish all labor, materials, and services and complete the construction of certain buildings and other improvements on a tract of land in Orange County owned by the Defendant, G. T. McArthur, and all extras to be included therein and furnished thereto, for the total aggregate sum of $20,500.00.

2. That the said McArthur and Chambers paid to said Michael & Embree $15,000.00 on said Contract price and price for extras agreed upon, and subsequent to such payment the said Michael & Embree were placed into bankruptcy and the Plaintiff, Hofler, is Trustee in Bankruptcy for them.

3. That a dispute arose as to the balance due Michael & Embree under the Above mentioned building Contract, the defendants McArthur and Chambers claiming that Michael & Embree had not constructed the buildings and improvements contemplated under the terms of the Contract in accordance with Plans and Specifications therefor, and had in several particulars failed and refused to carry out the Contract in accordance with its terms

and thereby the said McArthur and Chambers had been damaged and that the amount of the damage sustained by them by virtue of the alleged acts and omissions of the contractors was in excess of the balance which was otherwise due by McArthur and Chambers to the Contractors under the terms of said contract; that the plaintiff, Hofler as trustee in bankruptcy, instituted this action against McArthur and Chambers for the recovery of the amount of $9,695.71, alleging that said sum was the balance due after crediting the payment of $15,000, which sum sued for is the same amount as set out and alleged to be due in Exhibit "A" of a Notice of Lien filed in Orange County by Michael & Embree, Contractors, against the defendants, McArthur and Chambers, on the 14th day of January, 1955; that said action was tried in the Superior Court of Durham County at the June 1956 Civil Term, at which time the Jury fixed the amount of the unpaid balance under the contract between Michael & Embree and McArthur and Chambers for all improve-[fol. 24c] ments and extras as $5,250, as set out in the said Judgment signed by the Court; that said Judgment was duly docketed in the Office of the Clerk of the Superior Court of Durham County and a transcript thereof was also docketed in the Office of the Clerk of the Superior Court of Orange County.

4. After the defendants, McArthur and Chambers, had paid to the contractors, Michael & Embree, the sum of $15,000 on said Contract and the price for extras agreed upon, and before the said McArthur and Chambers paid the said $5,250 established by the Jury's verdict and set forth in the Judgment signed at June 1956 Civil Term in this action as being the full balance due on said Contract and contract for extras, certain persons and corporations filed written notices with the said McArthur and Chambers claiming that certain materials furnished by them to Michael & Embree, Contractors, had not been paid for by the said Michael & Embree and some of said persons and corporations further notified the said McArthur and Chambers to retain a sufficient amount out of any balance which might be due under said contract with the contractors for the purpose of paying the said claims of these materialmen; that, as set out above, Michael & Embree

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filed a Notice of Lien in the office of the Clerk of the Superior Court of Orange County on or about the 14th day of January, 1955, in which they listed the names of certain laborers and materialmen who they claimed had furnished labor and materials as set out in said Notice of Lien.

5. McArthur and Chambers are ready and able to pay the balance of $5250 and interest to this date and the costs of the Court accrued to this date, but if they do so without having made as parties to this action the materialmen and laborers who claimed to have furnished materials and labor to Michael & Embree for said project they might not be protected by such payment, and, therefore, the said materialmen and laborers listed as interpleaded defendants are proper and necessary parties for a complete determination of the matters set forth in the Bill of Interpleader in order to be bound by the decision of this Court, and in Order to prevent a multiplicity of suits.

6. That an Involuntary Petition in Bankruptcy was filed in the U. S. District Court for the Middle District of North Carolina against Michael & Embree on the 3rd day of January, 1955, and the U. S. District Judge entered an Order on the 16th day of January, 1955, formally adjudicating said Michael & Embree as Bankrupts. Thereafter W. Hance Hofler was elected Trustee in Bankruptcy of said Michael and Embree, Contractors and is now acting in that capacity.

7. The Plaintiff in this action caused an execution to [fol. 24d] issue upon the judgment obtained by him against McArthur and Chambers and the Sheriff of Durham County now has said Execution and had threatened to levy upon and sell the property of the said McArthur and Chambers in satisfaction of such Execution, and will do so unless permanently restrained by the Court, resulting in irreparable damage to the defendants G. T. McArthur and R. L. Chambers.

Upon the foregoing findings the Court is of the opinion that:

1. The referee in bankruptcy has jurisdiction to determine priorities as between the various claims to or against the fund of $5250 represented by the Judgment

recovered in this action of Hofler, Trustee in Bankruptcy against G. T. McArthur and R. L. Chambers, and the priority of such claims of such persons, firms, and corporations will have to be worked out in such Bankruptcy Court.

2. The said material furnishers and laborers who furnished materials and labor to Michael & Embree and who gave Notice of their claims to McArthur and Chambers after said McArthur and Chambers had paid $15,000 on the contract price and price for extras and prior to the payment by them of the Judgment of $5250 have no claim of any kind against G. T. McArthur and R. L. Chambers, and no claims or liens upon any of their property, other than such rights and claims as they may have in and to the fund of $5250 represented by the payment of the Judgment recovered by Hofler, Trustee, against McArthur and Chambers in this action, the amounts and priorities of such rights and claims in and to said fund to be determined in the Bankruptcy Court, as heretofore stated.

3. The Motion to strike, filed by the plaintiff, should be overruled.

4. The defendant, McArthur and Chambers, are entitled to the relief prayed for in their Supplemental Answer and Bill of Interpleader, except to the extent as otherwise provided in the Judgment.

5. The Notices of Lien appearing upon the Lien Docket in the Office of the Clerk of the Superior Court of Orange County in behalf of Michael & Embree as claimants in one Notice and R. D. Adams, F. H. Adams, P. F. Adams, Jr., and J. D. Adams, trading and doing business as Adams Concrete Products Company as claimants in the other notices constitute encumbrances of record and clouds upon the title of all of the real estate owned by the said defendant G. T. McArthur, which is described and referred to in the said respective Notices and Claims of Lien, and such encumbrances and clouds should be removed from the record.

[fol. 24e] NOW, THEREFORE, IT IS ORDERED, ADJUDGED AND DECREED by the Court:

1. That the said McArthur and Chambers pay to the Plaintiff, W. Hance Hofler, trustee in bankruptcy for Aubrey H. Michael and Edward L. Embree, Jr., individ-

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ually and trading as Michael & Embree, Contracts, the sum of $5250 with interest thereon from the date the said Judgment was docketed in the Office of the Clerk of the Superior Court of Durham County, and computed to the date of the signing of this Judgment; and that they pay to the Clerk of the Superior Court of Durham County the Court costs which have accrued in this action to this date; said G. T. McArthur and R. L. Chambers being hereby fully authorized to use the check signed by G. T. McArthur payable to cash in the sum of $5700 and certified by the bank, which check was deposited by the said McArthur and Chambers with the Clerk of the Superior Court of Durham County as security for the Stay Bond which was filed herein; and the Clerk of the Superior Court of Durham County is hereby fully authorized and directed to surrender and deliver the said check to the said McArthur and Chambers so that they may use the proceeds therefrom to pay the principal of said Judgment and the interest and cost computed as herein specified.

2. Upon the payment by the said McArthur and Chambers to the said W. Hance Hofler, Trustee in Bankruptcy, of the said Judgment and interest computed thereon to the date of this Judgment, and to the Clerk of the Superior Court of the Court costs accruing to the date of this Judgment, the said Judgment shall be ordered cancelled of record, and the said Trustee in Bankruptcy is hereby directed to cancel the said Judgment of record.

3. Upon the payment of said Judgment by the said McArthur and Chambers, as herein specified, the Execution in the hands of the Sheriff of Durham County shall be returned by the said Sheriff of Durham County to the Clerk of the Superior Court of Durham County and be considered null and void.

4. Upon the payment of said Judgment by McArthur and Chambers to the Trustee in Bankruptcy, as herein specified, the said W. Hance Hofler, Trustee in Bankruptcy, is ordered and directed to cause to be cancelled of record the judgment or transcript of judgment in this case which was docketed in the Office of the Clerk of the Superior Court of Orange County, and to also cancel of record the Notice of claim of Lien filed by Michael &

Embree against McArthur and Chambers in the Office of the Clerk of the Superior Court of Orange County.

[fol. 24f] 5. Upon the payment of said judgment of W. Hance Hofler, trustee in bankruptcy, against McArthur and Chambers, as herein specified, the Notice and claim of lien filed by Adams Concrete Products Co., against the defendants, McArthur and Chambers, in the office of the Clerk of the Superior Court of Orange County, is hereby ordered cancelled of record, and the said Impleaded Defendants, Adams Concrete Products Co., are hereby ordered and directed to cause the record of said Notice and Claim of Lien to be marked cancelled of record, and the Clerk of the Superior Court of Orange County is hereby authorized and directed to make an entry upon the Lien Docket in his office that said Notice and Claim of Lien has been directed and ordered to be marked cancelled of record.

6. Upon the payment of said Judgment of Hofler, Trustee, in Bankruptcy, against McArthur and Chambers, the Impleaded defendants, Adams Concrete Products Co., and their attorney and agents are permanently enjoined and restrained from proceeding further with the trial of the institution of any further proceedings in Orange Superior Court in the case of Adams Concrete Products Co., against the said defendants, McArthur and Chambers, and the said Adams Concrete Products Co., and their attorneys are ordered and directed to have said action dismissed from the docket as in case of non-suit.

7. Upon the payment of said Judgment of Hofler, Trustee in Bankruptcy against McArthur and Chambers, the Impleaded defendant, Noland Company, Inc., and its attorneys and agents, are permanently enjoined and restrained from bringing to trial or taking any further proceedings in the Wake Superior Court in the action instituted by Noland Co., Inc., against the defendants, G. T. McArthur and R. L. Chambers, and said Noland Co., Inc., and its attorneys are hereby ordered and directed to have the said action dismissed from the docket as in case of non-suit.

8. That upon payment of said Judgment of Hofler, Trustee in Bankruptcy against McArthur and Chambers, as herein specified, all of the Impleaded Defendants

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named in this action be and they are hereby enjoined and forever and permanently restrained and barred from instituting any actions, claims, suits or proceedings, against the defendants, G. T. McArthur and R. L. Chambers, or either of them or their heirs and assignes, on account of any claims or demands for labor, materials, or services allegedly furnished by any of said persons, firms, and corporations to Michael & Embree, Contractors, and allegedly used in the construction of the improvements on the property of G. T. McArthur referred to in [fol. 24g] this action; and the payment of said sum of $5250, plus interest computed to the date of this judgment and costs accruing in this action to the date hereof, as herein directed by the Court, is hereby adjudged to be in full satisfaction, settlement, exoneration, and discharge of all liability of the defendant, G. T. McArthur and R. L. Chambers, to the plaintiff, W. Hance Hofler, Trustee in Bankruptcy for Michael & Embree, to both Aubrey H. Michael and Edward L. Embree, Jr., individually and trading as Michael & Embree, Contractors, and to each and every one of the defendants named and designated in the Supplemental Answer and Bill of Interpleader filed in this proceeding, and their claims and demands and liens, if any, are hereby transferred to the said fund of $5250 and interest thereon computed as herein specified, which will be in the hands of the Trustee in Bankruptcy, and their equities, claims, and priorities shall be worked out in said fund in accordance with the orders and directions of the Bankruptcy Court.

9. The Motion to Strike from the Supplemental Answer and Bill of Interpleader is hereby overruled.

Entered this the 22nd day of May, 1957.

(Signed) Clawson L. Williams
Judge presiding over and holding the Superior Court for the Fourteenth Judicial District

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[fol. 25] IN THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 7619

UNITED STATES OF AMERICA, APPELLANT

v.

DURHAM LUMBER COMPANY, a corporation, and GEORGE H. CARTER, JR., formerly trading as DIXIE CONCRETE AND SUPPLY COMPANY, APPELLEES

In the Matter of

Aubrey H. Michael & Edward L. Embree, Jr.,
Ind. and T/A Michael & Embree,
Contractors, Bankrupt.

Appeal from the United States District Court for the Middle District of North Carolina, at Greensboro.

DOCKET ENTRIES

February 7, 1958, record on appeal filed and appeal docketed.

February 7, 1958, order of Johnson J. Hayes, United States District Judge, extending the time to and including the 6th day of February, 1958, within which to file the record and docket cause in the United States Court of Appeals for the Fourth Circuit, filed.

February 7, 1958, appearance of Charles K. Rice, Assistant Attorney General, and Lee A. Jackson, Attorney, Department of Justice, entered for the United States.

February 11, 1958, appearance of Arthur Vann entered for the appellee George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company.

February 12, 1958, appearance of Robert L. Gavin, United States Attorney, and Lafayette Williams, Assistant United States Attorney, entered for the appellant.

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February 13, 1958, appearance of Daniel M. Williams, Jr., entered for the appellee Durham Lumber Company, a corporation.

[fol. 26] March 8, 1958, appearance of Charles K. Rice, Assistant Attorney General, Lee A. Jackson, A. F. Prescott and Louise Foster, Attorneys, Department of Justice, entered for the claimant-appellant.

March 8, 1958, brief and appendix for the claimant-appellant filed.

March 25, 1958, brief and appendix for the claimant-appellees filed.

MINUTE ENTRY OF ARGUMENT AND SUBMISSION—
April 15, 1958

(Omitted in printing)

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[fol. 27] IN UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 7619

UNITED STATES OF AMERICA, APPELLANT

v.

DURHAM LUMBER COMPANY, a corporation, and GEORGE H. CARTER, JR., formerly trading as DIXIE CONCRETE AND SUPPLY COMPANY, APPELLEES

In the Matter of Aubrey H. Michael & Edward L. Embree, Jr., Ind. and T/A Michael & Embree, Contractors, Bankrupt.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA, AT GREENSBORO.

Argued April 15, 1958.

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Before SOBELOFF, Chief Judge, HAYNSWORTH, Circuit Judge, and PAUL, District Judge.

Louise Foster, Attorney, Department of Justice, (Charles K. Rice, Assistant Attorney General; Lee A. Jackson [fol. 28] and A. F. Prescott, Attorneys, Department of Justice; Robert L. Gavin, United States Attorney, and Lafayette Williams, Assistant United States Attorney, on brief) for Appellant; Arthur Vann for George H. Carter, Jr., etc., Appellee; and Daniel M. Williams, Jr., for Durham Lumber Co., Appellee.

OPINION—decided July 18, 1958

HAYNSWORTH, Circuit Judge:

This appeal presents a question of the relative rights of the United States, claiming under a tax lien upon the

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properties of a general contractor, and certain subcontractors, claiming in their individual rights against the owners of improved real estate. The District Court held, we think properly, that the subcontractors had the prior right in the particular fund.

Michael & Embree, general contractors, completed certain construction work in July 1954, but the owners disputed the amount of the balance due under the construction contract. Shortly thereafter, uncollected taxes were assessed to the general contractor, upon the basis of which a lien arose, in favor of the United States, upon all of the general contractor's property and rights to property. Internal Revenue Code of 1954, § 6321 (26 USCA § 6321). Later, certain subcontractors, who had not been paid, filed with the owners notices of their claims pursuant to the provisions of the General Statutes of North Carolina, § 44-9. Meanwhile, the general contractor-taxpayer had filed a petition in bankruptcy.

The Trustee in Bankruptcy brought an action against the owners for the balance claimed to be due on the con- [fol. 29] struction contract and obtained a judgment in the Superior Court for Durham County, North Carolina, for $5,250.00. The owners thereupon petitioned the Bankruptcy Court for permission to satisfy the judgment, *pro tanto,* by paying subcontractors and materialmen who had filed appropriate notices with them. As a result of extensive negotiations in which the subcontractors participated, the parties agreed to petition the Superior Court to reopen the case there, join the subcontractors as parties and enter an order which would permit the owners to pay to the Trustee the balance due, without prejudice to the rights of the subcontractors in the fund. An appropriate order was entered purporting to preserve the claims and rights of the subcontractors but substituting as the obligor the fund in the hands of the Trustee in the stead of the owners and their improved property.

The Government frankly states that it was understood that the conflicting rights of all parties would be determined in the Bankruptcy Court as if the matter, with all proper parties, was still in the state court. We, thus, need not be concerned with the subsequent procedures, but are required to consider the conflicting claims of the United States and the subcontractors as if the owners had

continued to withhold payment of the amount of the judgment.

The Referee concluded, as a matter of law, that the rights of the United States under its tax lien were superior to those of the subcontractors. The District Judge disagreed and, accordingly, modified the order of the Referee.

There is no doubt of the priority of the Federal tax lien over a mechanic's lien when the two liens attach to the same property. A mechanic's lien is not one of those [fol. 30] preferred interests to which the Congress has extended priority over the tax lien. Internal Revenue Code of 1954, § 6323 (26 USCA § 6323). *United States* v. *White Bear Brewing Co., Inc.*, 350 U. S. 1010, 76 S. Ct. 646, 100 L. Ed., 871. If the owner, rather than the general contractor, had been the delinquent taxpayer, the Federal tax lien reaching all of the owner's property, would outrank the claims of subcontractors, whether or not those claims had been protected with perfected mechanic's liens. It is equally clear that any claims of the subcontractors against the general contractor-taxpayer are subordinate to the tax lien attaching to all of the general contractor's property. But we are confronted with a different situation, one which calls for an examination of the nature of the right of the subcontractor, as asserted in North Carolina, against the owner of the improved property.

Prior to 1874, the statutes of North Carolina provided a lien upon improved real estate to secure the payment of "all debts contracted for work done on the same, or material furnished." Preservation of the lien was contingent upon a timely filing of a notice in the office of the Clerk of the Superior Court and a timely institution of an action to enforce the lien. This is still the statutory scheme for the protection of the rights of general contractors. General Statutes of North Carolina, §§ 44-1, 44-38, 44-39, 44-40, 44-43.

In 1874, however, it was held in *Wilkie* v. *Bray*, 71 N. C. 205, that the statute created liens only for the benefit of persons in privity of contract with the owner and that no lien was created for the protection of a subcontractor. This decision led to a series of new statutes conferring new rights upon subcontractors and creating

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new interests for their protection. See *Morganton Mfg.* [fol. 31] *& Trading Co.* v. *Anderson*, 165 N. C. 285, 81 S. E. 418; *Lester* v. *Houston*, 101 N. C. 605, 8 S. E. 366; *Charlotte Pipe & Foundry Co.* v. *Southern Aluminum Co.*, 172 N. C. 704, 90 S. E. 923.

The statutes adopted after 1874, expressly created a lien for the protection of subcontractors which is preferred to that arising in favor of the general contractor.[1] The general contractor, before receiving any payment from the owner, is required to file with the owner a statement of all sums due subcontractors, and the owner is directed to pay such sums directly to the subcontractors rather than to the general contractor.[2] A contractor who fails to furnish such a statement is guilty of a misdemeanor,[3] but, whether he does or not, a subcontractor may furnish the owner with a statement of his account. If he does so, a lien immediately arises in his favor, and, thereafter, no "payment to the contractor shall be a credit on or a discharge of the lien * * *."[4] The requirement that notice of the lien be filed in the office of the Clerk of the Superior Court is made inapplicable, notice to the owner being all that is required.[5] The lien, as an interest in the real estate of the owner, is extinguished if the subcontractor does not commence an action to enforce it within six months after the notice,[6] but the requirement that the owner make payment to the subcontractor in preference to the general contractor remains in effect, and the subcontractor may maintain an action against [fol. 32] the owner, at any time within the period of general limitations, to compel compliance with that duty.[7]

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[1] General Statutes of North Carolina, § 44-6.

[2] General Statutes of North Carolina, § 44-8.

[3] General Statutes of North Carolina, § 44-12.

[4] General Statutes of North Carolina, § 44-9.

[5] General Statutes of North Carolina, § 44-10.

[6] *Hildebrand* v. *Vanderbilt*, 147 N. C. 639, 61 S. E. 620.

[7] *Hildebrand* v. *Vanderbilt*, 147 N. C. 639, 61 S. E. 620; *Charlotte Pipe & Foundry Co.* v. *Southern Aluminum Co.*, 172 N. C. 704, 90 S. E. 923; *Guilford Lumber Mfg. Co.* v. *Holladay*, 178 N. C. 417, 100 S. E. 597; *Campbell* v. *Hall*, 187 N. C. 464, 121 S. E. 761; *Schnepp* v. *Richardson*, 222 N. C. 228, 22 S. E. 2d 555.

It is clear that under the North Carolina statutes the subcontractor who notifies the owner of his claim has (1) a lien upon the improved real estate superior to any lien which the general contractor may obtain, and (2) an independent cause of action against the owner, maintainable in his own name and in his own right, without regard to the time limitations upon the commencement of suit to enforce a lien, and the owner, after notice, may not avoid or reduce his direct liability to the subcontractor by any payment to, or settlement with, the general contractor. In any settlement with the general contractor, the owner may take credit for payments made by him to subcontractors, and he is required by statute to withhold sufficient funds to pay all of the claims of subcontractors of which he has notice. The obligation of the owner to the subcontractor is, thus, primary; his obligation to the general contractor, secondary.[8]

The subcontractor also has a claim against the general contractor. If we consider only this aspect of his right and if the subcontractor was proceeding in aid of his right to payment by the general contractor, this case would present no difficulty. The tax lien is clearly entitled to priority over the general claims of subcontrac-[fol. 33] tors seeking payment out of the property or interests in property of the general contractor, to which the tax lien has attached. But to define the right of the general contractor to receive payment of the contract price, subject, as we have seen, to the prior rights of subcontractors, as a property right reached by the tax lien does not convert this case into one of simple solution upon application of the established principle that the tax lien has priority over a mechanic's lien when both attach to the same property. We may not ignore the facts that the tax lien reaches the properties of the general contractor, not those of the owners, and that the independent rights of the subcontractors are asserted against the owners and their properties, not against the taxpayer or its properties. The priority of the tax lien

[8] The limitation that the aggregate of the owner's liabilities to subcontractors may not exceed his contract obligation is of no moment here, for the amount still due by the owners was more than sufficient to pay the outstanding claims of the subcontractors.

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in the division and distribution of the properties of the taxpayer, to which it attaches, is not to be extended to a like priority in the division or distribution of the properties of the taxpayer's debtor, to which the tax lien does not reach. Nor should the tax lien on the properties of the taxpayer extinguish private rights and liabilities as between other persons who do not claim through or in the right of the taxpayer.

As the statutes of North Carolina expressly provide, the owners may not discharge their debt to the subcontractors, of whose claims they have notice, by any payment to the general contractor. This is true whether or not the general contractor reduces his claim to judgment and whether or not the United States, through a tax lien, has become one of the "owners"[9] of the claim of the general contractor. The subcontractors are still entitled to proceed against the owners and to payment of their claims out of the assets of the owners. Should the [fol. 34] owners answer such a suit with a plea in bar that the claim of the general contractor had been acquired by the United States under a tax lien, it would stand on no higher plane than a plea of voluntary payment to the general contractor. Seizure by the United States under a tax lien of the claim of the general contractor cannot extinguish the statutory rights and obligations of a subcontractor and a North Carolina owner as between each other.

This is the right asserted by the subcontractors here. They do not seek payment out of the properties of the general contractor which are subject to the tax lien. Their claims are addressed to the owners. To the extent that the owners may be allowed to take credit for the amount of their claims in any settlement with the general contractor, the existence of the claims are relevant to an appraisal of the worth of the claim of the general contractor. That is a consequence of the nature of the rights as created and limited by the statutes, but it does not force the subcontractor to look to the assets of the general contractor, rather than to those of the owner, for satisfaction of his claim. Nor does it permit us to deny

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[9] *United States* v. *City of Greenville*, 4 Cir., 118 F. 2d 963, 965.

enforcement of the subcontractors' statutory rights against solvent owners. At the most, it can mean only that, except to the extent the claim of the general contractor exceeds the aggregate of the claims of the subcontractors, the general contractor has no right which is subject to seizure under the tax lien.

That was the conclusion of the Court of Appeals for the Second Circuit in Fidelity and Deposit Company of Maryland v. New York City Housing Authority, 2 Cir., 241 F. 2d 142. There it was carefully pointed out that it is a federal function, in applying federal revenue laws, to classify state-created rights and interests and to de-[fol. 35] termine their relative priorities, but the rights and interests themselves are creatures of the state. If the delinquent taxpayer has no right under state laws, there is nothing upon which the tax lien may attach. The court there found that the provisions of the general construction contract, under the laws of New York, created a preference for the claims of subcontractors, asserted against the owner, over those of the general contractor-taxpayer, and, therefore, concluded that the general contractor-taxpayer had no right which the tax lien could reach. The more decided preference, under the laws of North Carolina, of the claims of the subcontractors leads us to the same conclusion.

The only question recognized as being before the court in the earlier case of *United States* v. *Kings County Iron Works*, 2 Cir., 224 F. 2d 232, was the one of relative priority of competing claims to the same fund. In such a contest, the tax lien must always be the victor over the claims of subcontractors. Later, however, when the very different situation with which we are confronted was clearly presented to the same court in the Fidelity and Deposit case, it was recognized that the tax lien may prevail over the claims of subcontractors only when they compete for recognition in the same property or right.

In *Aquilino* v. *United States*, 3 N. Y. 2d 511, 146 N. E. 2d 774, the New York Court of Appeals reached a conclusion apparently at variance with our own. The opinion indicates no awareness of the decision in the Fidelity and Deposit case, but construed Kings County Iron Works

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to stand for the proposition that the tax lien on the property of the general contractor would prevent the assertion of the rights of subcontractors against the owner. Had the New York Court of Appeals been informed of the decision of the Court of Appeals for the [fol. 36] Second Circuit in Fidelity and Deposit, indeed had it felt at liberty to accord full recognition to the state-created right of the subcontractor against the owner, it may have reached a different conclusion.

That the Court of Appeals of New York should have accorded greater recognition to the state created rights is strongly indicated by the very recent case of United States v. Bess, —— U. S. ——, —— S. Ct. ——, —— L. Ed. —— (decided June 9, 1958) in which it was held that the tax lien could attach only to such rights as had been created and limited by state law. Section 3670, it was said, merely attaches federally defined consequences to state created rights. In stating the proposition, the Supreme Court cited with approval the decision of the Court of Appeals for the Second Circuit in *Fidelity and Deposit, supra.* Had the New York Court of Appeals adopted the same approach in *Aquilino,* it hardly could have avoided the conclusion that where the state created right of the general contractor was at all times secondary and subordinate the attachment of the Tax lien does not elevate it to a status of primacy and preference.

The rights of the subcontractors as here asserted against the owners are not liens. Each of them acquired a lien on the real estate of the owner when he gave notice of his claim, but no one of them instituted an action to foreclose the lien within six months after the notice, and they may not now do so. But their statutory right to payment by the owners persists and may be enforced by them. Their claims are preferred to that of the general contractor, but, with respect to others, their standing is that of a common creditor of the owners. But theirs is a valuable right which is not extinguished by the tax lien on the property of the general contractor, whose only claim against the owners under [fol. 37] the laws of North Carolina, is for so much of the construction price as will remain unpaid after the

owners have deducted a sum sufficient to pay the subcontractors.

We agree with the District Judge that the balance of the construction price should be applied first to payment in full of the claims of the subcontractors, and then only may the remainder be disbursed as an asset of the bankrupt estate.

Affirmed.

[fol. 38] • • • •

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[fol. 39] IN UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 7619

UNITED STATES OF AMERICA, APPELLANT

v.

DURHAM LUMBER COMPANY, a corporation, and GEORGE H. CARTER, JR., formerly trading as DIXIE CONCRETE AND SUPPLY COMPANY, APPELLEES

In the Matter of

Aubrey H. Michael & Edward L. Embree, Jr.,
Ind. and T/A Michael & Embree,
Contractors, Bankrupt.

APPEAL FROM the United States District Court for the Middle District of North Carolina.

JUDGMENT—Filed and Entered July 18, 1958

THIS CAUSE came on to be heard on the record from the United States District Court for the Middle District of North Carolina, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered, adjudged and decreed by this Court that the order of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed.

SIMON E. SOBELOFF
Chief Judge, Fourth Circuit.

CLEMENT F. HAYNSWORTH, JR.
United States Circuit Judge.

JOHN PAUL
United States District Judge.

August 19, 1958, mandate issued and transmitted to the Clerk of the United States District Court at Greensboro, North Carolina.

August 19, 1958, record on appeal returned to the Clerk of the United States District Court at Greensboro, North Carolina.

(File Endorsement Omitted)

[fol. 40] Clerk's Certificate to foregoing transcript omitted in printing.

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[fol. 41] SUPREME COURT OF THE UNITED STATES

(Title omitted)

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—October 10, 1958

UPON CONSIDERATION of the application of counsel for petitioner,

IT IS ORDERED that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including December 15th, 1958.

/s/ Earl Warren
Chief Justice of the United States

Dated this 10th
day of October, 1958.

[fol. 42] SUPREME COURT OF THE UNITED STATES

No. 579, October Term, 1958

(Title omitted)

ORDER ALLOWING CERTIORARI—February 24, 1959

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit is granted. The case is transferred to the summary calendar and assigned for argument immediately following No. 132.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

☆ U. S. GOVERNMENT PRINTING OFFICE, 1959 506184 1478

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Reasons for granting the writ	6
Conclusion	14
Appendix A	15
Appendix B	38

CITATIONS

Cases:

Aquilino v. *United States*, 3 N. Y. 2d 511	13, 14
Berry, Charles W., Houses (Aetna Casualty & Surety Co.) v. *United States*, decided April 30, 1958 (App. N. Y.)	14
Brick Co. v. *Pulley*, 168 N. C. 371	11
Fidelity & Deposit Co. v. *New York City Housing Auth.*, 241 F. 2d 142	12, 13
Foundry Co. v. *Aluminum Co.*, 172 N. C. 704	11
Hardware Co. v. *Schools*, 151 N. C. 507	11
Powder Co. v. *Denton*, 176 N. C. 426	11
United States v. *Acri*, 348 U. S. 211	7
United States v. *Bess*, 357 U. S. 51	13
United States v. *Colotta*, 350 U. S. 808, reversing 79 So. 2d 474 (Miss.)	7, 8, 14
United States v. *Gilbert Associates*, 345 U. S. 361	7, 9
United States v. *Hulley*, No. 300, this Term, decided November 10, 1958, reversing 102 So. 2d 599 (Fla.)	7, 8, 14
United States v. *Kings County Iron Works*, 224 F. 2d 232	13
United States v. *Liverpool & London Ins. Co.*, 348 U. S. 215	7
United States v. *New Britain*, 347 U. S. 81	7, 8, 9
United States v. *Scovil*, 348 U. S. 218	7, 9
United States v. *Security Tr. & Sav. Bk.*, 340 U. S. 47	7, 9, 12

Cases—Continued

	Page
United States v. *Vorreiter*, 355 U. S. 15, reversing 134 Colo. 543	7, 8, 14
United States v. *White Bear Brewing Co.*, 350 U. S. 1010, reversing 227 F. 2d 359	7, 8, 14
Widenhouse v. *Russ*, 234 N. C. 382	11

Statutes:

Internal Revenue Code of 1954:	
Sec. 6321 (26 U. S. C. 1952 ed., Supp. V, Sec. 6321)	8, 38
Sec. 6322 (26 U. S. C. 1952 ed., Supp. V, Sec. 6322)	38
Sec. 6323 (a) (26 U. S. C. 1952 ed., Supp. V, Sec. 6323 (a))	8, 9, 38
General Statutes of North Carolina (Recompiled 1950):	
Sec. 44–1	39
Secs. 44–6 to 44–14	11
Sec. 44–6	11, 39
Sec. 44–8	11, 40
Sec. 44–9	40
Sec. 44–10	41
Sec. 44–11	11, 41
Sec. 44–38	42
Sec. 44–39	42
Sec. 44–43	11, 42
Sec. 44–48	11, 42

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In the Supreme Court of the United States

OCTOBER TERM, 1958

No. ——

UNITED STATES OF AMERICA, PETITIONER

v.

DURHAM LUMBER COMPANY, A CORPORATION, AND GEORGE H. CARTER, JR., FORMERLY TRADING AS DIXIE CONCRETE AND SUPPLY COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit.

OPINIONS BELOW

The memorandum opinion of the District Court (Appendix A, *infra,* pp. 23–25) is not officially reported. The opinion of the Court of Appeals (Appendix A, *infra,* pp. 26–35) is reported at 257 F. 2d 570.

JURISDICTION

The judgment of the Court of Appeals was entered on July 18, 1958. (Appendix A, *infra,* p. 36.) By order of the Chief Justice, dated October 10, 1958,

the time for filing a petition for a writ of certiorari was extended to and including December 15, 1958. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

Whether, in the distribution of a fund determined by state court judgment to be owing to the taxpayer, a state "statutory right to payment" is entitled to priority over a federal tax lien which arose and was recorded before the "statutory right to payment" first came into existence.

STATUTES INVOLVED

Sections 6321, 6322, 6323 of the Internal Revenue Code of 1954, and Sections 44–1, 44–6, 44–8, 44–9, 44–10, 44–11, 44–38, 44–39, 44–43, and 44–48 of the General Statutes of North Carolina (Recompiled 1950) are set forth in Appendix B, *infra,* pp. 38–43.

STATEMENT

This case arises from bankruptcy proceedings in the District Court for the Middle District of North Carolina. At issue is the relative priority of federal tax liens and the claims of certain subcontractors to a fund recovered by the trustee in bankruptcy as the balance due on a construction contract to a general contractor who is indebted to the United States for unpaid withholding and social security taxes. (Appendix A, *infra,* p. 21.) The facts are undisputed and may be stated as follows:

The taxpayer-bankrupts are two individuals (Michael and Embree) who were doing business as

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general contractors in and around Durham, North Carolina. On July 15, 1954, they completed construction of some camp buildings for certain persons who will be referred to herein as "owners". (Appendix A, *infra,* pp. 16–17.) Shortly thereafter, on August 13, 1954, and November 22, 1954, federal withholding and unemployment insurance taxes were assessed against the taxpayers in the respective amounts of $4,017.53 and $3,254.73. A notice of lien for the first amount was filed in the office of the Register of Deeds of Durham County on November 2, 1954. (Appendix A, *infra,* p. 19).

Respondent Dixie Concrete and Supply Company gave notice to the owners of its claim for $3,089.54 on January 12, 1955, and respondent Durham Lumber Company gave notice to the owners of its claim for $366.93 in February, 1955. (Appendix A, *infra,* p. 18.)[1] Neither respondent, however, brought suit within six months, as required by North Carolina law in order to perfect a mechanic's lien. (Appendix A, *infra,* p. 35.)

On January 18, 1955, the taxpayers were adjudicated bankrupts in the United States District Court (hereinafter called "the Bankruptcy Court"). At that time there was an unpaid balance of $5,250 due from the owners to the taxpayer-bankrupts under the construction contract. The owners, however, disputed

[1] Another subcontractor, the Durham Brazing & Welding Company, whose claim is not involved here, gave notice of its claim to the owners on June 20, 1955. Five other subcontractors claiming liens, but whose claims likewise are not involved here, did not give any notice to the owners. (Appendix A, *infra,* p. 18.)

the amount and contended that there was nothing due. The trustee in bankruptcy instituted suit against the owners in the Superior Court of Durham County, North Carolina, and obtained a jury verdict for the disputed amount. Judgment on the verdict was entered on June 7, 1956. (Appendix A, *infra*, p. 17.)

Thereupon the owners petitioned the Bankruptcy Court for permission to pay subcontractors who had furnished materials in connection with the construction work and had given notice of that fact to the owners, but who had not been joined as parties in the trustee's action. Extensive negotiations were had between the trustee, the owners, and the subcontractors, two of which (the Adams Concrete & Block Company and Nolan & Company) had instituted separate actions against the owners. Eventually, the owners moved to reopen the proceedings in the state court and made the subcontractors parties. The Nolan Company also filed a petition in the Bankruptcy Court for permission to make the trustee a party to its action. Finally, a compromise agreement, approved by the Bankruptcy Court, was effected whereby the claims of the Adams Company and the Nolan Company were settled for a total of $465.63, to be paid from the amount of the judgment obtained by the trustee against the owners. The order of the state court required the owners to pay over to the trustee the balance due, and transferred the liens to the fund and discharged the owners from the claims of the lien claimants. Thereupon the owners paid to the trustee the amount of the judgment, $5,250, plus interest of

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$250. It was understood among the parties that their rights in this fund would be determined in the Bankruptcy Court the same as if they were in the state court. The Director of Internal Revenue was never a party to any of these actions. (Appendix A, *infra*, pp. 17–18.)

The Referee in Bankruptcy determined that the fund should first be applied to pay trustee's commission, his attorney's fee, the compromise settlement, and court costs, in the total amount of $1,885.63 (leaving a balance of $3,614.37, less than the amount of the first federal lien). Second priority was accorded to the tax claims of the United States on the ground that its liens were prior to those of the three subcontractors which were not involved in the compromise settlement and which had notified the owners of their claims. These three subcontractors—the two respondents and a third subcontractor whose claim is not involved here [2]—were accorded a third priority on a *pro rata* basis. The remaining five subcontractors were held not to have liens on the proceeds since they had not given notice of their claims to the owners as required by the laws of North Carolina. (Appendix A, *infra*, pp. 19–20.)

The only adverse claimants which filed exceptions to the order of the Referee, insofar as that order granted priority to the tax liens of the United States as against their claims, were the two respondent subcontractors. (Appendix A, *infra*, p. 23.) The District Court allowed the exceptions and modified the order

[2] See note 1, *supra*.

of the Referee accordingly. (Appendix A, *infra*, pp. 23–25.) The Court of Appeals for the Fourth Circuit affirmed the decree of the District Court. (Appendix A, *infra*, pp. 26–37.)

The Court of Appeals, although relying on the North Carolina lien statutes, acknowledged that "The rights of the subcontractors as here asserted against the owners are not liens. Each of them acquired a lien on the real estate of the owner when he gave notice of his claim, but no one of them instituted an action to foreclose the lien within six months after the notice, and they may not now do so. But their statutory right to payment by the owners persists and may be enforced by them. Their claims are preferred to that of the general contractor, but, with respect to others, their standing is that of a common creditor of the owners." (Appendix A, *infra*, p. 35.) This "statutory right to payment," the court held, is entitled to priority over the federal liens.

REASONS FOR GRANTING THE WRIT

The two federal tax liens involved here arose before either respondent's "statutory right to payment" had arisen. In addition, the first of the two federal liens was *recorded* before either respondent's "statutory right to payment" had arisen, and this federal lien is of an amount greater than the fund now in issue. In both respects, therefore, the decision of the court below, holding that respondents' claims are entitled to priority over the federal liens, is in direct conflict with numerous decisions of this Court, in particular the recent decision in *United States* v. *Hulley*, No. 300, this Term, decided November 10, 1958 (27 U. S. L.

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Week 3148), summarily reversing 102 So. 2d 599 (Fla.).

In view of this conflict, and in view of the continuing importance of the question presented, we submit that review and reversal of the decision below are fully warranted in order to preserve uniformity in the federal scheme of taxation. See *United States* v. *Gilbert Associates,* 345 U. S. 361, 364.

1. Even in the case where a mechanic's lien is recorded before the federal lien arises, this Court has held that the federal lien takes priority if additional steps are necessary to perfect the mechanic's lien. *United States* v. *Colotta,* 350 U. S. 808, summarily reversing 79 So. 2d 474 (Miss.); *United States* v. *White Bear Brewing Co.,* 350 U. S. 1010, summarily reversing 227 F. 2d 359 (C. A. 7th); *United States* v. *Vorreiter,* 355 U. S. 15, summarily reversing 134 Colo. 543.[3]

The decision below is not only in conflict with those holdings, but goes considerably further; for, as already noted, the first federal lien here arose and was recorded before either "statutory right to payment"

[3] These decisions applied the rationale of *United States* v. *Security Trust & Savings Bank,* 340 U. S. 47, that the effect of a local statutory lien in relation to the federal tax lien is always a federal question; that a prior inchoate lien under state law cannot take preference over a subsequent federal tax lien; and that the local lien remains inchoate, and unperfected in this sense, while it is "contingent upon taking subsequent steps for enforcing it" (340 U. S. at 51). This rationale was also reaffirmed in *United States* v. *Acri,* 348 U. S. 211; *United States* v. *Liverpool & London Ins. Co.,* 348 U. S. 215; and *United States* v. *Scovil,* 348 U. S. 218. See also *United States* v. *New Britain,* 347 U. S. 81, 86.

had arisen. Indeed, the decision below goes further than *United States* v. *Hulley, supra,* which involved a mechanic's lien and not merely a "statutory right to payment," and where the mechanic's lien at least arose prior to the recording of the federal lien. Like *Hulley,* however, this case can be decided simply upon the basis of the fundamental principle enunciated in *United States* v. *New Britain,* 347 U. S. 81, 85, that "the first in time is the first in right." Application of this principle clearly requires a reversal of the decision below, even apart from the rationale of the *Colotta, White Bear,* and *Vorreiter* decisions, *supra.*

2. The respondents filed their claims against the owners in January and February 1955. Until those claims were filed, the respondents concededly had no claim against the owners. Several months earlier, the first federal lien (which was recorded on November 2, 1954) arose on August 13, 1954. On the latter date, this federal lien attached to "all property and rights to property, whether real or personal, belonging to" the taxpayer. Section 6321 of the Internal Revenue Code of 1954 (Appendix B, *infra,* p. 38). As the state court necessarily determined by its judgment, the owners were then indebted to the taxpayer in the amount of $5250 (plus interest); and this amount was in fact paid to the taxpayer's trustee in bankruptcy. It thus follows that the federal lien attached to the fund (or the chose in action on which it was based) long prior to the time that respondents had any "statutory right to payment."

Aside from the four categories of lienors specifically excepted by Section 6323 (Appendix B, *infra,*

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pp. 38–39)—mortgagees, pledgees, purchasers, and judgment creditors—even a genuine lien (as distinguished from respondents' "statutory right to payment") which arises subsequent in time to a federal tax lien is clearly not entitled to priority over the federal lien. *United States* v. *New Britain, supra.* And, since neither "statutory right to payment" had been reduced to judgment prior to the recording of the federal liens, Section 6323 is inapplicable here.[4] Indeed, as already pointed out, the first federal lien was recorded even before either "statutory right to payment" came into existence. The decision below thus elevates the respondents to a status which is not even enjoyed by mortgagees, pledgees, purchasers, and judgment creditors. The decision, we believe, can be justified only on the theory that a mere debt—not even rising to the level of an inchoate lien—displaces a federal lien which had previously arisen, had previously been recorded, and had previously attached to the property involved. Numerous decisions of this Court (*supra,* pp. 6–7) are all to the contrary.

3. In granting priority to respondents' "statutory right to payment" over a prior recorded federal lien, the court below recognized that "There is no doubt of the priority of the Federal tax lien over a mechanic's lien when the two liens attach to the same

[4] The four categories of Section 6323 are to be defined according to the conventional meaning of the terms. See *United States* v. *Scovil*, 348 U. S. 218, 221 ("purchaser"); *United States* v. *Gilbert Associates*, 345 U. S. 361, 364–365 ("judgment creditor"). See also *United States* v. *Security Trust & Savings Bank*, 340 U. S. 47, 52 (concurring opinion of Mr. Justice Jackson).

property". (Appendix A, *infra,* p. 28.) But the court thought it was "confronted with a different situation" here (*ibid.*); according to the court (*id.*, p. 31), it could "not ignore the facts that the tax lien reaches the properties of the general contractor, not those of the owners, and that the independent rights of the subcontractors are asserted against the owners and their properties, not against the taxpayer or its properties." Contrary to the court's statement, however, it is patent that both the tax lien and the "statutory right to payment" do relate "to the same property"—*i. e.*, the indebtedness of the owners to the taxpayer-contractor.

More specifically, from August 13, 1954 (when the federal lien arose) at least until January 12, 1955 (when the first "statutory right to payment" arose), the owners were indebted to the taxpayer-contractor and the federal lien unquestionably attached to that indebtedness. It is only by ignoring this chronology that the court could say that "the general contractor has no right which is subject to seizure under the tax lien." The contractor-taxpayer clearly had such a right at least until January 12, 1955, and the federal lien had clearly attached by that time. On the other hand, as the court below recognized, a subcontractor under North Carolina law has no right whatever against the owners prior to giving notice, and even then has only a right to have an accounting in an ordinary civil action and judgment for "the amount due the original contractor at the time of notice

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given." (Appendix B, *infra,* p. 40.)[5] When notice

[5] Liens and rights of subcontractors are set forth in Chapter 44 (entitled "Liens") of the General Statutes of North Carolina, Article 2, Section 44–6 to Section 44–14. The purpose and effect of these sections is treated in detail by the Supreme Court of North Carolina in *Foundry Co.* v. *Aluminum Co.*, 172 N. C. 704, 706–707. The court there states that the dominant ideas of the statute are that the laborer and materialman may by notice protect themselves to the extent of the contract price; that the owner shall not be liable beyond the amount due the contractor at the time the notice is given; and when a lien is once acquired upon the property "by giving notice," the amount due the contractor shall be distributed among the claimants *pro rata.* See *Widenhouse* v. *Russ*, 234 N. C. 382, 384; *Powder Co.* v. *Denton*, 176 N. C. 426, 432; *Brick Co.* v. *Pulley*, 168 N. C. 371, 375.

As the court pointed out in the *Foundry Co.* case, *supra*, the lien is acquired by notice to the owner, and the amount due the contractor at the time of notice is not a debt due by the owner in the ordinary sense, but a trust fund. The statute furnishes subcontractors "a double security"; (*a*) a lien on the property of the owner (Section 44–6, Appendix B, *infra*, pp. 39–40) [Revisal, Sec. 2019], and (*b*) then imposes upon the owner the duties of a trustee "with respect to the amount due the contractor," and requires him to distribute the amount *pro rata* among subcontractors (Section 44–11, Appendix B, *infra*, pp. 41–42) [Revisal, Sec. 2023]. The first requires an action to enforce it, but is lost, as the court below held (Appendix A, *infra*), where, as here, action is not brought upon the lien within six months (Sections 44–43 and 44–48, Appendix B, *infra*, pp. 42–43) [Revisal, Secs. 2027, 2033 (4)], while the second does not "in strictness" create a lien, but a right to have an accounting in an ordinary civil action and judgment "for the amount due by the owner to the contractor."

When written statement of the subcontractor is furnished the owner in accord with the statute (Sections 44–8 and 44–11, Appendix B, *infra*, pp. 40, 41–42) [Revisal, Secs. 2021, 2023], a direct obligation upon the part of the owner to a subcontractor may be created, upon which he may sue in his own name. However, the right to share *pro rata* in the fund due from the owner to the contractor is a statutory right, dependent upon acquiring a lien on the property by giving notice to the owner. See *Hardware Co.* v. *Schools*, 151 N. C. 507, 509.

was given in the instant case, the property was already encumbered by the paramount federal lien.*

According to the court below, "Seizure by the United States under a tax lien of the claim of the general contractor cannot extinguish the statutory rights and obligations of a subcontractor and a North Carolina owner as between each other". (Appendix A, *infra*, p. 32.) Whatever may be the validity of that proposition, it has no relevance here. The question here is, instead, whether "the statutory rights and obligations of a subcontractor and a North Carolina owner as between each other" can extinguish the "[s]eizure by the United States under a tax lien of the claim of the general contractor", where the tax lien not only arose but also was recorded even before there came into existence "the statutory rights and obligations" referred to by the court.

4. The reliance of the court below upon the decision of the Second Circuit in *Fidelity & Deposit Co.* v. *New York City Housing Auth.*, 241 F. 2d 142, even

*There is therefore no basis for the suggestion by the court below that a contrary decision might result in double liability of the owners. (Appendix A, *infra*, p. 32.) As pointed out, the North Carolina statutes limit a subcontractor's "statutory right to payment" to "the amount due the original contractor at the time of notice given." (Appendix B, *infra*, p. 40.) In the instant case, when notice was given by the respondents, the amount formerly due the taxpayer-contractor was then due to the United States, which had acquired the chose in action under its tax lien. And it is well settled that the doctrine of "relation back" cannot be used to defeat a prior federal lien. See *United States* v. *Security Trust & Savings Bank*, 340 U. S. 47, 50.

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if that decision be correct, is misplaced. There, the taxpayer-contractor breached its contract with the owner—*i. e.*, a special provision requiring payment of the laborers and materialmen as a condition precedent to receipt of any part of the contract price—and the Second Circuit held that accordingly there was no debt due to the taxpayer-contractor and that the taxpayer-contractor had no right to which the federal lien could attach. In the instant case, it is indisputable that the owners were indebted to the taxpayer-contractor. That fact, indeed, was conclusively determined by a state court judgment (*supra*, p. 4). The Government's position is thus completely in accord with *United States* v. *Bess*, 357 U. S. 51, 55, stating that the federal lien statute "creates no property rights but merely attaches consequences, federally defined, to rights created under state law * * *." See also *United States* v. *Kings County Iron Works*, 224 F. 2d 232 (C. A. 2).

With respect to *Aquilino* v. *United States*, 3 N. Y. 2d 511, 146 N. E. 2d 774, now pending on petition for certiorari, No. 132, this Term, the court below states that there "the New York Court of Appeals reached a conclusion apparently at variance with our own" but that the New York court "may have reached a different conclusion" if it had been informed of the Second Circuit's *Fidelity & Deposit* decision, *supra*. The short answer is that in the reported *Aquilino* opinion (p. 516)[7] the New York Court of Appeals cited and

[7] Although the court below cites the reported *Aquilino* opinion, it may have had reference to an unofficial slip opinion which apparently did not cite *Fidelity & Deposit*.

distinguished *Fidelity & Deposit.*[8] The only "variance" between *Aquilino* and the decision below, we submit, is that *Aquilino* is in accord with established law in this field, whereas the decision below is not.

CONCLUSION

The question presented has been authoritatively settled by this Court in several decisions. In our view, the matter is so clear as to justify the granting of certiorari and reversal of the judgment below without the need for oral argument or further briefs.[9]

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

EARL E. POLLOCK,
Assistant to the Solicitor General.

A. F. PRESCOTT,
GEORGE F. LYNCH,
Attorneys.

DECEMBER 1958.

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[8] See also that court's decision in *Charles W. Berry Houses (Aetna Casualty & Surety Co.)* v. *United States*, decided April 30, 1958 (58–2 U. S. T. C., par. 9778).

[9] This was the disposition of the *Colotta*, *White Bear*, *Vorreiter*, and *Hulley* cases, *supra*, pp. 6–7.

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APPENDIX A

In the District Court of the United States for the Middle District of North Carolina

In Bankruptcy No. 1918

In the Matter of Aubrey H. Michael & Edward L. Embree, Jr., Ind. and T/A Michael & Embree, Contractors

Minutes of the Final Meeting of Creditors

Bankrupt:

The final creditors meeting in the above case was duly held at the time and place as designated in the Notice to Creditors at which time there were present the Referee, the Trustee and interested parties.

The Report of the Trustee was made available for the inspection and examination of the creditors and there were no objections made to said report.

The following fees and expenses were found to be fair and reasonable and approved and directed to be paid as follows:

Herman A. Smith, U. S. Clerk costs as per separate order	$718.48
W. Hance Hofler:	
Trustee's fee	461.29
Trustee's expenses	
Daniel K. Edwards (This includes $1,200 allocated in the lien order), Attorney for Trustee, fee	3,000.00
Expense of Trustee's Attorney	
Rufus W. Reynolds, advanced for telephone calls	7.88
Rufus W. Reynolds, travel expenses advanced	
E. K. Powe, Attorney for Bankrupt, fee	400.00
Daniel K. Edwards:	
Attorney for Petitioning Creditors, fee	200.00
Attorney for Petitioning Creditors, expenses	
Bank of Greensboro, N. C., Intangible tax for current year	10.41

Office Service Company, Preparing notices, etc., for Referee, special work			$6.10
Charles W. White, State Receiver			300.00
Total			5,104.16
It appeared that there was a balance on hand of			13,884.91
After paying the above expenses there will be a balance of			8,780.75

to be applied as far as it will go in the following order:

Wages as follows:			
Pfd. Claim No. 10	J. W. Thames	$200.00	
Pfd. Claim No. 11	J. W. Thames	52.84	
			252.84
Adams Concrete Company		135.00	
Nolan Company (arising out of obtaining judgment against McArthur & Chambers, see order below)		------	
			465.65
Director of Internal Revenue—lien as filed in Durham County, on Nov. 2, 1954			4,017.53
Director of Internal Revenue—withholding and FICA assessment date Nov. 22, 1954—lien (not filed in Durham County)			3,254.73

Material Claims Which are Liens on Chambers-McArthur Judgment after Director of Internal Revenue Lien

Claimant	*Amt. of Claim*	*20% Dividend*	
Durham Brazing & Welding Company	$360.78	$14.68	
Dixie Concrete & Supply Company	3,088.54	639.36	
Durham Lumber Company	364.93	75.96	
	3,816.25		790.00
			8,780.75

Order

Upon the petition of certain material furnishers and the claims by the Director of Internal Revenue, and after hearing the evidence, the argument of counsel, and consideration of briefs, the following facts and conclusions of law are made:

1

The bankrupts were general contractors doing business in and around Durham, North Carolina. They filed a voluntary petition in bankruptcy on January 3,

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1955, and were adjudicated bankrupts on January 18, 1955.

2

That during the first part of 1954 the bankrupts entered into a contract to build certain camp buildings for G. T. McArthur and R. L. Chambers, hereinafter referred to as "Owners". The buildings were completed on July 15, 1954. At the date of bankruptcy there was an unpaid balance of $5250.00 due from the Owners to the bankrupts on the said contract. However, the Owners disputed the amount and contended that there was nothing due.

3

The Trustee instituted suit against the Owners in the Superior Court of Durham County, North Carolina, and finally won a jury verdict of $5250.00. The judgment on the verdict was entered on June 7, 1956. Shortly after the judgment was rendered the owners petitioned the bankrupt court for permission to pay certain material furnishers or subcontractors of the bankrupts who had given the owners notice of furnishing such material. At that time it appeared to the Owners that they had failed to include in the action or join as parties in the Trustee's action the alleged subcontractors of the bankrupt. Adams Concrete Company and Nolan and Company had already instituted suits against the Owners. These two suits were not combined with the Trustee's suit.

4

Extensive negotiations went on between the Trustee, the material furnishers and the Owners. Finally the Owners made a motion in the Superior Court to reopen the proceeding and make parties the alleged material furnishers. Nolan and Company filed a petition

in the bankruptcy court for permission to make the Trustee a party to its action. Finally in Superior Court in order to get the judgment and matters settled the Trustee marked out an agreement and obtained permission of the bankruptcy court to compromise and settle the Nolan claim in the original amount of $741.25 for the sum of $300.00 plus $30.45 court costs, and settle the suit involving the Adams Concrete and Block Company which was in the original amount of $228.63 for $123.00 plus $10.00 court costs, with the understanding that this amount would be paid from the judgment collected from Chambers & McArthur. After this agreement was entered, then the Owners voluntarily paid the judgment in the amount of $5250.00 plus $250.00 interest. It was understood that the parties who might be entitled to this fund would be determined in the bankruptcy court the same as if they were in the Superior Court. The Director of Internal Revenue was never party to any of those three actions.

5

The Durham Brazing & Welding Company whose claim is in the amount of $360.70 gave notice to the Owners of its claim on June 20, 1955. The Dixie Concrete & Supply Company whose claim is $3,089.54, gave notice to the Owners on January 12, 1955. The Durham Lumber Company, whose claim is in the amount of $366.93, gave notice in February, 1955. The other subcontractors and material furnishers claiming a lien did not give any notice. They are as follows: Genn Hosiery Mill, $374.15; Gwalty Oil Company, $334.64; Lovett Electric Company, $437.50; Nello L. Teer Company, $355.07; Peedan Steel Company, $820.29.

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The Director of Internal Revenue claims a lien on the amount collected from the Owners as well as a lien on the other assets of the bankrupts by reason of withholding and F. I. C. A. taxes assessed August 13, 1954, filed in the Register of Deeds Office of Durham County on the 2nd day of November, 1954, on which there is a present balance due of $4,017.53 and a tax claim for withholding and F. I. C. A. assessed November 22, 1954, in the amount of $3,254.73. The Trustee and his attorney spent several days in trying, arguing and collecting the judgment from the Owners. Reasonable compensation which the attorney for the Trustee earned is found to be $1,200.00. The bankruptcy court costs on the amount recovered is 2%, and the Trustee's commission is 2%, making a total cost of $1,420.00 which should be allocated and paid from the judgment. This allocation and expense is included in the above attorney's fee and Trustee's fee and court costs.

CONCLUSIONS OF LAW

7

The $135.00 compromise and agreement with Adams Concrete and Block Company and the $330.63 compromise with Nolan and Company was legal and necessary and was part of the costs of procuring the settlement and judgment and that this sum should be first taken from the amount of the judgment. After then deducting the costs of obtaining the judgment, the Director of Internal Revenue has a lien prior to the liens as claimed by the Durham Brazing & Welding Company, Dixie Concrete and Supply Company and the Durham Lumber Company which position is supported by the following cases:

U. S. v. *The White Bear Brewing Co.*, 350 U. S. 1010 (1956)
U. S. v. *Collata* (1955), 350 U. S. 800
U. S. v. *Kings County Iron Works, Inc.* (C. A. 2nd 1955), 224 Fed. 232
Brust v. *Starr* (C. A. 2nd 1956), 237 Fed. 2nd 135
United States v. *England* (C. A. 9th 1955), 226 Fed. 2nd 205
United States v. *City of New Brittain* (1953), 347 U. S. 81

8

The material and subcontract claimants who did not file any notice with the Owners are not entitled to any liens on any proceeds of the judgment by reason of the fact that such notice must be given pursuant to the statutes of North Carolina before any lien is created or any right to any funds in the hands of the Owners is established.

WHEREFORE, IT IS ORDERED that after the application of the balance of the funds on hand to the lien by the Director of Internal Revenue, the unpaid balance of the liens as above computed in the minutes of the final creditors meeting be paid from the judgment from McArthur & Chambers and that the remainder after deducting the said liens by the Director of Internal Revenue be paid prorata on the claims of Durham Brazing & Welding Company, Dixie Concrete & Supply Company, and Durham Lumber Company as above indicated.

IT IS FURTHER ORDERED that the claimants as subcontractors and material furnishers who did not file any notice with the Owners are not entitled to any liens on any of the proceeds.

This the 22d day of August, 1957.

(s) RUFUS W. REYNOLDS,
Referee in Bankruptcy.

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[Caption omitted]

CERTIFICATE BY REFEREE TO JUDGE

I, Rufus W. Reynolds, Referee of said Court, do hereby certify that in the course of proceeding in the said cause before me, upon the hearing of claims of liens by material furnishers and subcontractors of the Bankrupt and the Director of Internal Revenue as to the amount, validity and priority, the following question was presented:

> Where Trustee for general contractors recovers balance due on construction contracts and the Director of Internal Revenue assesses taxes against the Bankrupt before bankruptcy and before subcontractors of the Bankrupt give notice of lien to Owners, who has prior lien, Director of Internal Revenue or subcontractors?

Upon considering the evidence I made findings as set out in the order as attached hereto. Said findings were made after considering the testimony, documentary evidence and argument of counsel.

WHEREUPON, on the 22nd day of August, 1957, I entered an order allowing the lien by the Director of Internal Revenue Senior to the subcontractors' liens, first satisfying the Director's liens from other assets in the bankrupts' estate.

WHEREUPON, petitions for review of said order by the Judge were filed by George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company, and Durham Lumber Company.

Attached to this certificate are the following documents:

1. Petition for Review by George H. Carter, Jr., formerly trading as Dixie Concrete and supply Company.
2. Petition for Review by Durham Lumber Company.

3. Petition by Chambers & McArthur to compromise judgment and apply payments on judgment.

4. Petition by Noland Company, Inc., to join Trustee as party in action.

5. Order approving compromise with Noland Company, Inc., and Adams Concrete Company.

6. Petition by Trustee to give material claimants notice to establish claims.

7. Order by Referee dated July 1, 1957, directing alleged material furnishers to establish liens.

8. Service of notice on alleged claim holders.

9. Notice to all creditors and alleged lien holders of hearing on claims for lien.

10. Proceedings of the action in State Court by Trustee against G. T. McArthur and R. L. Chambers.

11. Claims of liens as filed by:

(A) Durham Brazing and Welding Works
(B) Pedra Steel Company
(C) Lovette Electric Construction Company
(D) Nello L. Teer Company
(E) Durham Lumber Company
(F) George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company

12. Briefs as filed by:

(A) U. S. Treasury Department
(B) Durham Brazing and Welding Works

13. Letter from E. K. Powe, Attorney for the Bankrupt.

14. Letter from Daniel K. Edwards, Attorney for the Trustee.

15. Order entered by Referee, dated August 22, 1957, determining priority and amount of claim. (The order is combined with final distribution of

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funds on hand in order that a picture of the entire matter can be ascertained.)

This the 4th day of September, 1957.

(s) RUFUS W. REYNOLDS,
Referee in Bankruptcy.

[Caption omitted]

MEMORANDUM OPINION

HAYES, *District Judge:*

Exceptions to the order of the Referee in Bankruptcy were filed by Geo. H. Carter, Jr. formerly trading as Dixie Concrete and Supply Co., and Durham Lumber Co., in so far as the order gave the United States tax lien priority over them.

The Referee applied the doctrine of priority usually applicable to the distribution of assets belonging to the bankrupt and relied primarily on *United States* v. *White Bear Brewing Co.,* 350 U. S. 1010, reversing 7th Circuit in 227 Fed. 2d 359. There the bankrupt was the owner of real property which had been improved by a person asserting a mechanic's lien. Priority of liens as between the United States and such a claimant for a mechanic's lien was the issue determined.

In the instant case the owner is not the bankrupt; the contractor is the bankrupt. It is therefore necessary to determine whether the asset in question was the sole property of the bankrupt before the *White Bear* case, *supra,* applies.

The contractor (bankrupt) agreed to furnish and pay for all labor and materials and erect the improvements for a stated sum, free from all liens against the property.

When the contractor was adjudged a bankrupt, the work had been completed and a balance was due the contractor if the labor and materialmen's liens were discharged.

The trustee sued the contractor and obtained a judgment for the balance of the contract price. However, the two excepting creditors gave the statutory notice to the owner of the amounts due them by the contractor for labor and materials furnished by them in the performance of the contract. They did all required of them to establish a valid lien against the property of the owner—not the bankrupt contractor.

After the trustee obtained a judgment against the owner but before paying the judgment, the Superior Court, rendering the judgment, made an order, pursuant to the law of North Carolina, *Swiggins* v. *Buss Co.*, 230 N. C. 234, making these lien claimants parties to the original action. That court, with all the parties before it, required the defendant owner to pay over to the trustee the balance due, and transferred the liens to the fund and discharged the owner from their claims. The state court permitted the fund to come into the hands of the trustee impressed with such liens thereon as the claimants possessed, to be determined by the bankruptcy court. It was not provided in the order or implied in it, that the funds was an asset of the bankrupt free from the liens of these claimants.

Since the state court discharged the owner from these claims and transferred the liens to the fund, it

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follows that the fund in the possession of the trustee is subject to whatever valid liens existed at the time of the transfer. Under the law of North Carolina, where a laborer, materialman or subcontractor gives the required statutory notice to the owner his lien immediately attaches to any balance due by the owner to the original contractor, and payment to the contractor thereafter will not discharge the owner from the lien of such a claimant. The fund was required by the law of North Carolina to be applied first in discharge of these liens before it became an asset of the bankrupt contractor. *Schnepp* v. *Richardson,* et al., 222 N. C. 228; *Assurance Society* v. *Basnight* et al., 234 N. C. 347.

The usual order of distribution of the assets of a bankrupt undoubtedly controls the disposition of assets owned by the bankrupt but cannot be enlarged to include assets not belonging to the bankrupt. *Fidelity and Deposit Co.* v. *New York City Housing Authority,* 241 F. 2d 142 2d cir. 0. The exceptions are allowed and the order of the Referee is modified accordingly.

This the 14th day of October 1957.

(s) JOHNSON J. HAYES,
United States District Judge.

Exception allowed to the United States October 14, 1957.

HAYES, *Judge.*

In the United States Court of Appeals for the Fourth Circuit

No. 7619

UNITED STATES OF AMERICA, APPELLANT

versus

DURHAM LUMBER COMPANY, A CORPORATION, AND GEORGE H. CARTER, JR., FORMERLY TRADING AS DIXIE CONCRETE AND SUPPLY COMPANY, APPELLEES

IN THE MATTER OF AUBREY H. MICHAEL & EDWARD L. EMBREE, JR., IND. AND T/A MICHAEL & EMBREE, CONTRACTORS, BANKRUPT

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA, AT GREENSBORO

(Argued April 15, 1958. Decided July 18, 1958)

Before SOBELOFF, *Chief Judge,* HAYNSWORTH, *Circuit Judge,* and PAUL, *District Judge*

Louise Foster, Attorney, Department of Justice (Charles K. Rice, Assistant Attorney General; Lee A. Jackson and A. F. Prescott, Attorneys, Department of Justice; Robert L. Gavin, United States Attorney, and Lafayette Williams, Assistant United States Attorney, on brief), for Appellant; Arthur Vann for George H. Carter, Jr., etc., Appellee; and Daniel M. Williams, Jr., for Durham Lumber Co., Appellee.

HAYNSWORTH, *Circuit Judge:*

This appeal presents a question of the relative rights of the United States, claiming under a tax lien upon the properties of a general contractor, and certain subcontractors, claiming in their individual rights

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against the owners of improved real estate. The District Court held, we think properly, that the subcontractors had the prior right in the particular fund.

Michael & Embree, general contractors, completed certain construction work in July 1954, but the owners disputed the amount of the balance due under the construction contract. Shortly thereafter, uncollected taxes were assessed to the general contractor, upon the basis of which a lien arose, in favor of the United States, upon all of the general contractor's property and rights to property. Internal Revenue Code of 1954, § 6321 (26 U. S. C. A. § 6321). Later, certain subcontractors, who had not been paid, filed with the owners notices of their claims pursuant to the provisions of the General Statutes of North Carolina, § 44–9. Meanwhile, the general contractor-taxpayer had filed a petition in bankruptcy.

The Trustee in Bankruptcy brought an action against the owners for the balance claimed to be due on the construction contract and obtained a judgment in the Superior Court for Durham County, North Carolina, for $5,250.00. The owners thereupon petitioned the Bankruptcy Court for permission to satisfy the judgment, *pro tanto*, by paying subcontractors and materialmen who had filed appropriate notices with them. As a result of extensive negotiations in which the subcontractors participated, the parties agreed to petition the Superior Court to reopen the case there, join the subcontractors as parties and enter an order which would permit the owners to pay to the Trustee the balance due, without prejudice to the rights of the subcontractors in the fund. An appropriate order was entered purporting to preserve the claims and rights of the subcontractors but substituting as the obligor the fund in the hands of the

Trustee in the stead of the owners and their improved property.

The Government frankly states that it was understood that the conflicting rights of all parties would be determined in the Bankruptcy Court as if the matter, with all proper parties, was still in the state court. We, thus, need not be concerned with the subsequent procedures, but are required to consider the conflicting claims of the United States and the subcontractors as if the owners had continued to withhold payment of the amount of the judgment.

The Referee concluded, as a matter of law, that the rights of the United States under its tax lien were superior to those of the subcontractors. The District Judge disagreed and, accordingly, modified the order of the Referee.

There is no doubt of the priority of the Federal tax lien over a mechanic's lien when the two liens attach to the same property. A mechanic's lien is not one of those preferred interests to which the Congress has extended priority over the tax lien. Internal Revenue Code of 1954, § 6323 (26 U. S. C. A. § 6323). *United States* v. *White Bear Brewing Co., Inc.*, 350 U. S. 1010, 76 S. Ct. 646, 100 L. Ed. 871. If the owner, rather than the general contractor, had been the delinquent taxpayer, the Federal tax lien reaching all of the owner's property, would outrank the claims of subcontractors, whether or not those claims had been protected with perfected mechanic's liens. It is equally clear that any claims of the subcontractors against the general contractor-taxpayer are subordinate to the tax lien attaching to all of the general contractor's property. But we are confronted with a different situation, one which calls for an examination of the nature of the right of the subcontractor,

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as asserted in North Carolina, against the owner of the improved property.

Prior to 1874, the statutes of North Carolina provided a lien upon improved real estate to secure the payment of "all debts contracted for work done on the same, or material furnished." Preservation of the lien was, contingent upon a timely filing of a notice in the office of the Clerk of the Superior Court and a timely institution of an action to enforce the lien. This is still the statutory scheme for the protection of the rights of general contractors. General Statutes of North Carolina, §§ 44–1, 44–38, 44–39, 44–40, 44–43.

In 1874, however, it was held in *Wilkie* v. *Bray*, 71 N. C. 205, that the statute created liens only for the benefit of persons in privity of contract with the owner and that no lien was created for the protection of a subcontractor This decision led to a series of new statutes conferring new rights upon subcontractors and creating new interests for their protection. See *Morganton Mfg. & Trading Co.* v. *Anderson*, 165 N. C. 285, 81 S. E. 418; *Lester* v. *Houston*, 101 N. C. 605, 8 S. E. 366; *Charlotte Pipe & Foundry Co.* v. *Southern Aluminum Co.*, 172 N. C. 704, 90 S. E. 923.

The statutes adopted after 1874, expressly created a lien for the protection of subcontractors which is preferred to that arising in favor of the general contractor.[1] The general contractor, before receiving any payment from the owner, is required to file with the owner a statement of all sums due subcontractors and the owner is directed to pay such sums directly to the subcontractors rather than to the general contractor.[2] A contractor who fails to furnish such a statement is

[1] General Statutes of North Carolina, § 44–6.

[2] General Statutes of North Carolina, § 44–8.

guilty of a misdemeanor,[3] but, whether he does or not, a subcontractor may furnish the owner with a statement of his account. If he does so, a lien immediately arises in his favor, and, thereafter, no "payment to the contractor shall be a credit on or a discharge of the lien * * * "[4] The requirement that notice of the lien be filed in the office of the Clerk of the Superior Court is made inapplicable, notice to the owner being all that is required.[5] The lien, as an interest in the real estate of the owner, is extinguished if the subcontractor does not commence an action to enforce it within six months after the notice,[6] but the requirement that the owner make payment to the subcontractor in preference to the general contractor remains in effect, and the subcontractor may maintain an action against the owner, at any time within the period of general limitations, to compel compliance with that duty.[7]

It is clear that under the North Carolina statutes the subcontractor who notifies the owner of his claim has (1) a lien upon the improved real estate superior to any lien which the general contractor may obtain, and (2) an independent cause of action against the owner, maintainable in his own name, and in his own right, without regard to the time limitations upon the commencement of suit to enforce a lien, and the owner, after notice, may not avoid or reduce his direct

[3] General Statutes of North Carolina, § 44–12.

[4] General Statutes of North Carolina, § 44–9.

[5] General Statutes of North Carolina, § 44–10.

[6] *Hildebrand* v. *Vanderbilt*, 147 N. C. 639, 61 S. E. 620.

[7] *Hildebrand* v. *Vanderbilt*, 147 N. C. 639, 61 S. E. 620; *Charlotte Pipe & Foundry Co.* v. *Southern Aluminum Co.*, 172 N. C. 704, 90 S. E. 923; *Guilford Lumber Mfg. Co.* v. *Holloday*, 178 N. C. 417, 100 S. E. 597; *Campbell* v. *Hall*, 187 N. C. 464, 121 S. E. 761; *Schnepp* v. *Richardson*, 222 N. C. 228, 22 S. E. 2d 555.

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liability to the subcontractor by any payment to, or settlement with, the general contractor. In any settlement with the general contractor, the owner may take credit for payments made by him to subcontractors, and he is required by statute to withhold sufficient funds to pay all of the claims of subcontractors of which he has notice. The obligation of the owner to the subcontractor is, thus, primary; his obligation to the general contractor, secondary.[8]

The subcontractor also has a claim against the general contractor. If we consider only this aspect of his right and if the subcontractor was proceeding in aid of his right to payment by the general contractor, this case would present no difficulty. The tax lien is clearly entitled to priority over the general claims of subcontractors seeking payment out of the property or interests in property of the general contractor, to which the tax lien has attached. But to define the right of the general contractor to receive payment of the contract price, subject, as we have seen, to the prior rights of subcontractors, as a property right reached by the tax lien does not convert this case into one of simple solution upon application of the established principle that the tax lien has priority over a mechanic's lien when both attach to the same property. We may not ignore the facts that the tax lien reaches the properties of the general contractor, not those of the owners, and that the independent rights of the subcontractors are asserted against the owners and their properties, not against the taxpayer or its properties. The priority of the tax lien in the division

[8] The limitation that the aggregate of the owner's liabilities to subcontractors may not exceed his contract obligation is of no moment here, for the amount still due by the owners was more than sufficient to pay the outstanding claims of the subcontractors.

and distribution of the properties of the taxpayer, to which it attaches, is not to be extended to a like priority in the division or distribution of the properties of the taxpayer's debtor, to which the tax lien does not reach. Nor should the tax lien on the properties of the taxpayer extinguish private rights and liabilities as between other persons who do not claim through or in the right of the taxpayer.

As the statutes of North Carolina expressly provide, the owners may not discharge their debt to the subcontractors, of whose claims they have notice, by any payment to the general contractor. This is true whether or not the general contractor reduces his claim to judgment and whether or not the United States, through a tax lien, has become one of the "owners"[*] of the claim of the general contractor. The subcontractors are still entitled to proceed against the owners and to payment of their claims out of the assets of the owners. Should the owners answer such a suit with a plea in bar that the claim of the general contractor had been acquired by the United States under a tax lien, it would stand on no higher plane than a plea of voluntary payment to the general contractor. Seizure by the United States under a tax lien of the claim of the general contractor cannot extinguish the statutory rights and obligations of a subcontractor and a North Carolina owner as between each other.

This is the right asserted by the subcontractors here. They do not seek payment out of the properties of the general contractor which are subject to the tax lien. Their claims are addressed to the owners. To the extent that the owners may be allowed to take credit for the amount of their claims in any settle-

[*] *United States* v. *City of Greenville*, 4 Cir., 118 F. 2d 963, 965.

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ment with the general contractor, the existence of the claims are relevant to an appraisal of the worth of the claim of the general contractor. That is a consequence of the nature of the rights as created and limited by the statutes, but it does not force the subcontractor to look to the assets of the general contractor, rather than to those of the owner, for satisfaction of his claim. Nor does it permit us to deny enforcement of the subcontractors' statutory rights against solvent owners. At the most, it can mean only that, except to the extent the claim of the general contractor exceeds the aggregate of the claims of the subcontractors, the general contractor has no right which is subject to seizure under the tax lien.

That was the conclusion of the Court of Appeals for the Second Circuit in Fidelity and Deposit Company of Maryland v. New York City Housing Authority, 2 Cir., 241 F. 2d 142. There it was carefully pointed out that it is a federal function, in applying federal revenue laws, to classify state-created rights and interests and to determine their relative priorities, but the rights and interests themselves are creatures of the state. If the delinquent taxpayer has no right under state law, there is nothing upon which the tax lien may attach. The court there found that the provisions of the general construction contract, under the laws of New York, created a preference for the claims of subcontractors, asserted against the owner, over those of the general contractor-taxpayer, and, therefore, concluded that the general contractor-taxpayer had no right which the tax lien could reach. The more decided preference, under the laws of North Carolina, of the claims of the subcontractors leads us to the same conclusion.

The only question recognized as being before the court in the earlier case of *United States* v. *Kings*

County Iron Works, 2 Cir., 224 F. 2d 232, was the one of relative priority of competing claims to the same fund. In such a contest, the tax lien must always be the victor over the claims of subcontractors. Later, however, when the very different situation with which we are confronted was clearly presented to the same court in the Fidelity and Deposit case, it was recognized that the tax lien may prevail over the claims of subcontractors only when they compete for recognition in the same property or right.

In *Aquilino* v. *United States,* 3 N. Y. 2d 511, 146 N. E. 2d 774, the New York Court of Appeals reached a conclusion apparently at variance with our own. The opinion indicates no awareness of the decision in the Fidelity and Deposit case, but construed Kings County Iron Works to stand for the proposition that the tax lien on the property of the general contractor would prevent the assertion of the rights of subcontractors against the owner. Had the New York Court of Appeals been informed of the decision of the Court of Appeals for the Second Circuit in Fidelity and Deposit, indeed had it felt at liberty to accord full recognition to the state-created right of the subcontractor against the owner, it may have reached a different conclusion.

That the Court of Appeals of New York should have accorded greater recognition to the state created rights is strongly indicated by the very recent case of United States v. Bess, —— U. S. ——, —— S. Ct. ——, —— L. Ed. —— (decided June 9, 1958) in which it was held that the tax lien could attach only to such rights as had been created and limited by state law. Section 3670, it was said, merely attaches federally defined consequences to state created rights.

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In stating the proposition, the Supreme Court cited with approval the decision of the Court of Appeals for the Second Circuit in *Fidelity and Deposit, supra.* Had the New York Court of Appeals adopted the same approach in *Aquilino,* it hardly could have avoided the conclusion that where the state created right of the general contractor was at all times secondary and subordinate the attachment of the tax lien does not elevate it to a status of primacy and preference.

The rights of the subcontractors as here asserted against the owners are not liens. Each of them acquired a lien on the real estate of the owner when he gave notice of his claim, but no one of them instituted an action to foreclose the lien within six months after the notice, and they may not now do so. But their statutory right to payment by the owner persists and may be enforced by them. Their claims are preferred to that of the general contractor, but, with respect to others, their standing is that of a common creditor of the owners. But theirs is a valuable right which is not extinguished by the tax lien on the property of the general contractor, whose only claim against the owners under the laws of North Carolina, is for so much of the construction price as will remain unpaid after the owners have deducted a sum sufficient to pay the subcontractors.

We agree with the District Judge that the balance of the construction price should be applied first to payment in full of the claims of the subcontractors, and then only may the remainder be disbursed as an asset of the bankrupt estate.

Affirmed.

Decree

Filed and Entered July 18, 1958

In the United States Court of Appeals for the Fourth Circuit

No. 7619

United States of America, appellant

vs.

Durham Lumber Company, a Corporation, and George H. Carter, Jr., Formerly Trading as Dixie Concrete and Supply Company, appellees

In the Matter of Aubrey H. Michael & Edward L. Embree, Jr., Ind., and T/A Michael & Embree, Contractors, Bankrupt

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA

This cause came on to be heard on the record from the United States District Court for the Middle District of North Carolina, and was argued by counsel.

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the order of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed.

Simon E. Sobeloff,
Chief Judge, Fourth Circuit.

Clement F. Haynsworth, Jr.,
United States Circuit Judge.

John Paul,
United States District Judge.

Filed July 18, 1958.

R. M. F. Williams, Jr., *Clerk.*

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August 19, 1958, mandate issued and transmitted to the Clerk of the United States District Court at Greensboro, North Carolina.

August 19, 1958, record on appeal returned to the Clerk of the United States District Court at Greensboro, North Carolina.

APPENDIX B

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U. S. C. 1952 ed., Supp. V, Sec. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, and the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U. S. C. 1952 ed., Supp. V, Sec. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITOR.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under State or Territorial Laws.*—In the office designated by the law of the State or

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Territory in which the property subject to the lien is situated,whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With Clerk of District Court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; * * *

* * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 6323.)

General Statutes of North Carolina (Recompiled 1950):

SEC. 44–1. *On buildings and property, real and personal.*—Every building built, rebuilt, repaired or improved, together with the necessary lots on which such building is situated, and every lot, farm or vessel, or any kind of property, real or personal, not herein enumerated, shall be subject to a lien for the payment of all debts contracted for work done on the same, or material furnished.

* * * * *

SEC. 44–6. *Lien given subcontractors, etc., on real estate.*—All subcontractors and laborers who are employed to furnish or who do furnish labor or material for the building, repairing or altering any house or other improvement on real estate, have a lien on said house and real estate for the amount of such labor done or material furnished, which lien shall be preferred to the mechanic's lien now provided by law, when notice thereof shall be given as hereinafter provided, which may be enforced as other liens in this chapter, except where it is otherwise provided; but the sum total of all the liens due subcontractors and materialmen

shall not exceed the amount due the original contractor at the time of notice given.

* * * * *

SEC. 44–8. *Statement of contractor's indebtdness to be furnished to owner; effect.*—When any contractor, architect or other person makes a contract for building, altering or repairing any building or vessel, or for the construction or repair of a railroad, with the owner thereof, it is his duty to furnish to the owner or his agent, before receiving any part of the contract price, as it may become due, an itemized statement of the amount owing to any laborer, mechanic or artisan employed by such contractor, architect or other person, or to any person for materials furnished, and upon delivery to the owner or his agent of the itemized statement aforesaid, it is the duty of the owner to retain from the money then due the contractor a sum not exceeding the price contracted for, which will be sufficient to pay such laborer, artisan or mechanic for labor done, or such person for material furnished, which said amount the owner shall pay directly to the laborer, mechanic, artisan or person furnishing materials. The owner may retain in his hands until the contract is completed such sum as may have been agreed on between him and the contractor, architect or other person employing laborers, as a guaranty for the faithful performance of the contract by such contractor. When such contract has been performed by the contractor such fund reserved as a guaranty shall be liable to the payment of the sum due the laborer, mechanic or artisan for labor done, or the person furnishing the materials as hereinbefore provided.

SEC. 44–9. *Subcontractors, laborers and materialmen may notify owner of claim; effect.*—Any subcontractor, laborer, mechanic, artisan,

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or person furnishing materials, who claims the lien provided for in this article for labor on, or materials furnished for, any building, vessel, railroad, or real estate, may give notice to the owner, agent or lessee who makes the contract for the labor or materials, of the amount due by the contractor to such claimant. The notice shall be in the form of an itemized statement of the amount due, except where the contract is entire for a gross sum and cannot be itemized. Upon the delivery of the notice to the owner, agent, or lessee, the claimant is entitled to all the liens and benefits conferred by law in as full a manner as though the statement were furnished by the contractor. If the said owner, agent or lessee refuses or neglects to retain, out of the amount due the contractor under the contract, a sum not exceeding the price contracted for which will be sufficient to pay such claimant, then the claimant may proceed to enforce his lien, and after such notice is given no payment to the contractor shall be a credit on or a discharge of the lien herein provided for.

SEC. 44–10. *Sums due by statement to constitute lien.*—The sums due to the laborer, mechanic or artisan for labor done, or due the person furnishing materials, as shown in the itemized statement rendered to the owner, shall be a lien on the building, vessel or railroad built, altered or repaired, without any lien being filed before a justice of the peace or the superior court.

SEC. 44–11. *Where sums due contractor from owner insufficient; payment pro rata.*—If the amount due the contractor by the owner is insufficient to pay in full the laborer, mechanic or artisan, for his labor, and the person furnishing materials, for materials furnished, it is the duty of the owner to distribute the amount pro rata among the several claimants, as shown by the itemized statement furnished

the owner, or of which notice has been given the owner by the claimant.

* * * * *

SEC. 44–38. *Claim of lien to be filed; place of filing.*—All claims against personal property, of two hundred dollars and under, may be filed in the office of the nearest justice of the peace; if over two hundred dollars or against any real estate or interest therein, in the office of the superior court clerk in any county where the labor has been performed or the materials furnished; but all claims shall be filed in detail, specifying the materials furnished or labor performed, and the time thereof. If the parties interested make a special contract for such labor performed, or if such material and labor are specified in writing, in such cases it shall be decided agreeably to the terms of the contract, provided the terms of such contract do not affect the lien for such labor performed or materials furnished.

SEC. 44–39. *Time of filing notice.*—Notice of lien shall be filed as hereinbefore provided, except in those cases where a shorter time is prescribed, at any time within six months after the completion of the labor or the final furnishing of the materials, or the gathering of the crops.

* * * * *

SEC. 44–43. *Action to enforce lien.*—Action to enforce the lien created must be commenced in the court of a justice of the peace, and in the superior court, according to the jurisdiction thereof, within six months from the date of filing the notice of the lien. But if the debt is not due within six months, but becomes due within twelve months, suit may be brought or other proceedings instituted to enforce the lien in thirty days after it is due.

SEC. 44–48. *Discharge of liens.*—All liens created by this chapter may be discharged as follows:

* * * * *

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4. By a failure of the claimant to commence an action for the enforcement of the lien within six months from the notice of lien filed.

U. S. GOVERNMENT PRINTING OFFICE: 1958

INDEX

	Page
Question presented	1
Statutes involved	1
Conclusion	5
Reasons for not granting the Writ	2
Appendix A	6

CITATIONS

Brick Co. v. Pully, 168 N. C. 371	4
Charlotte Pipe & Foundry Co. v. Southern Aluminium Co., 172 N. C. 704	3
Fidelity & Deposit co. v. New York City Housing Auth., 241 F. 2d 142	2
Guilford Lumber Mfg. Co. v. Holloday, 178 N. C. 417	3
Hildebrand v. Vanderbilt, 147 N. C. 639	3
Morgan v. Commissioners, 309 U. S. 78	2
Schnepp v. Richardson, 222 N. C. 228	3, 4
United States v. Bess, 257 U. S. 51	3, 4
United States v. Colotta, 350 U. S. 808	4
United States v. Vorreiter, 355 U. S. 15	4
United States v. White Bear Brewing Co., 350 U. S. 1010	4

Statutes

Internal Revenue Code of 1954

Section 6321 (26 U. S. C. 1952 ed., Supp. II, Sec. 6321)	1, 2

General Statutes of North Carolina (Recompiled 1950)

Section 44-1	1, 2
Section 44-6	1, 2
Section 44-8	1, 2
Section 44-9	1, 2
Section 44-10	1, 2
Section 44-11	1, 2
Section 44-12	1, 2, 6

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OCTOBER TERM, 1958

No. ———

UNITED STATES OF AMERICA, PETITIONER

v.

DURHAM LUMBER COMPANY, A CORPORATION, AND GEORGE H. CARTER, JR., FORMERLY TRADING AS DIXIE CONCRETE AND SUPPLY COMPANY

PETITION FOR A WRIT OF CRETIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

RESPONDENT'S BRIEF

QUESTION PRESENTED

Whether Federal Tax Lien enlarges the property rights or rights to property of a defaulting taxpayer, thereby extinguishing private rights and liabilities as between persons who do not claim by or through or in place of the defaulting taxpayer.

STATUTES INVOLVED

Sections 6321, 6322, 6323 of the Internal Revenue Code of 1954, and Sections 44-1, 44-6, 44-8, 44-9, 44-10, 44-11 of the General Statutes of North Carolina (Recompiled 1950) are set

forth in Appendix B, Petitioner's Brief, pp. 38-43; and Section 44-12 of the General Statutes of North Carolina (Recompiled 1950) as set forth in Appendix A, **infra., p. 6.**

REASONS FOR NOT GRANTING THE WRIT

The District Court and the Circuit Court were correct in holding that the funds involved were the property of the Respondents and that said funds were not the assets of the bankrupt contractor, the defaulting taxpayer. Under the laws of the State of North Carolina, contained in General Statutes, Sections 44-1, 44-6, 44-8, 44-9, 44-10, 44-11, (Appendix B, pp. 38-43, Petitioner's Brief), and 44-12 (Appendix A, **infra**, p. 6.), the unpaid monies in the hands of the owners were the property of the materialmen at all times until paid to the contractor.

It is clear, under the decisions of this Court, that legal interests and rights are created by state law, and that the Federal Revenue Acts designate what interests and rights shall be taxed. That Section 6321 of the Internal Revenue Code of 1954 (Appendix B, p. 38, Petitioner's Brief) imposes a tax lien on all property and rights to property belonging to the taxpayer. It is also clear from the decisions of this Court that the Internal Revenue Code does not create property interests or the rights to property, but that remains a matter for state law. **Morgan v. Commissioners,** 309 U. S. 78, 60 S. Ct.

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424, 84 L. Ed. 585; **Fidelity and Deposit Co. v. New York City Housing Authority,** 241 F. 2d 142; **United States vs. Bess,** 357 U. S. 51.

It is respectfully submitted that the United States Court of Appeals for the Fourth Circuit, in its opinion, correctly stated the property law of the State of North Carolina (Appendix A, Petitioner's Brief, pp. 26, 29-32) and that the same is a clear and concise statement of said property law. The highlights may be summarized as follows:

1. It is the primary obligation of the owners to pay the subcontractors after the notice of the claim. **Hildebrand v. Vanderbilt,** 147 N. C. 639, 61 S. E. 620; **Charlotte Pipe & Foundry Co. v. Southern Aluminum Co.,** 172 N. C. 704, 90 S. E. 923; **Guilford Lumber Mfg. Co. v. Holloday,** 178 N. C. 417, 100 S. E. 597; **Campbell v. Hall,** 187 N. C. 464, 121 S. E. 761; **Schnepp v. Richardson, 222** N. C. 228, 22 S. E. 2d 555.

2. The subcontractors may maintain an action against the owner, at any time within the period of general limitation, to compel payment of the obligation. **Hildebrand v. Vanderbilt, Supra.; Charlotte Pipe & Foundry Co. v. Southern Aluminum Co. Supra.; Campbell v. Hall, Supra.; Schnepp v. Richardson, Supra.**

3. The liability of the owner to the subcontractor is primary, his obligation to the contractor is secondary; this is true regardless of

the status of accounts between subcontractor and contractor. **Brick Co. v. Pully,** 168 N. C. 371, 84 S. E. 513, **Schnepp v. Richardson, Supra.**

It is, therefore, clear that at the time that the Federal Tax lien was filed, the contractor's only interest in any monies due from McArthur & Chambers was secondary to that of the subcontractors. The tax lien attached to the property and rights to property belonging to the taxpayer but not on property rights of others. **United States v. Bess, Supra.**

This case is not inconsistent with the cases of **United States v. Colotta,** 350 U. S. 808, summarily reversing 79 So. 2d 474 (Miss.); **United States v. White Bear Brewing Co.,** 350 U. S. 1010, summarily reversing 227 F. 2d 359 (C. A. 7th); **United States v. Vorreiter,** 355 U. S. 15, summarily reversing 134 Colo. 543., for the reason that these were cases involving priority of liens. The instant case does not involve priority of liens but involves whether or not the filing of a tax lien in favor of the United State imposes a lien on the property and rights to property of the defaulting taxpayer or whether, as in argued by the United States in this case, legal interests superior to the interests of the defaulting taxpayer shall be swept aside by the mere filing of the Federal Tax Lien, thereby in effect, creating in the United States legal interests superior to those held by the defaulting taxpayer.

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It is respectfully submitted that the tax liens on the property of the defaulting taxpayer do not and should not extinguish private rights and liabilities as between other persons who do not claim by or through or in place of the defaulting taxpayer.

CONCLUSION

The decisions of the District Court and the Court of Appeals for the Fourth Circuit are good law, and since this case is not in conflict with other decisions of this Court, the Writ of Certiorari should be denied.

Respectfully Submitted,

C. V. JONES & ARTHUR VANN
Attorneys for GEORGE H. CARTER, JR., formerly Trading as DIXIE CONCRETE & SUPPLY COMPANY

DANIEL M. WILLIAMS, JR.
Attorney for DURHAM LUMBER COMPANY.

APPENDIX A.

General Statutes of North Carolina (Recompiled 1950):

SEC. 44-12. Contractor failing to furnish statement, or not applying owners payments to laborers claims, misdemeanor. If any contractor or architect shall fail to furnish to the owner an itemized statement of the sums due to every one of the laborers, merchanics or artisans employed by him, or the amount due for materials, before receiving any part of the contract price, he shall be guilty of a misdemeanor. If any contractor shall fail to apply the contract price paid him by the owner or his agent to the payment of bills for labor and material, he shall be guilty of a misdemeanor and upon conviction thereof shall be fined or imprisioned or both, at the discretion of the court.

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Summary of Argument	6
Argument:	
Introduction	10
Federal tax liens on funds due a contractor from an owner have priority over subcontractors' statutory rights to payment which had not arisen when the federal lien came into existence and which, even after assertion, created only inchoate liens	11
A. Prior to the assertion of the subcontractors' "statutory right to payment," the United States had obtained an effective lien upon the property here involved, *i.e.*, the contractor's claim against the owners	11
B. The earlier tax lien of the United States has priority over the subsequently arising "statutory right to payment"	13
C. The contractor's claim against the owners did not cease to be property of the contractors (to which the federal tax lien attached) because the subcontractors could assert a "statutory right to payment" directly against the owners	15
D. Giving the subcontractors priority would result in extinguishing an existing federal lien through the rejected doctrine of "relation back"	24
Conclusion	26
Appendix	27

517028—59——1

CITATIONS

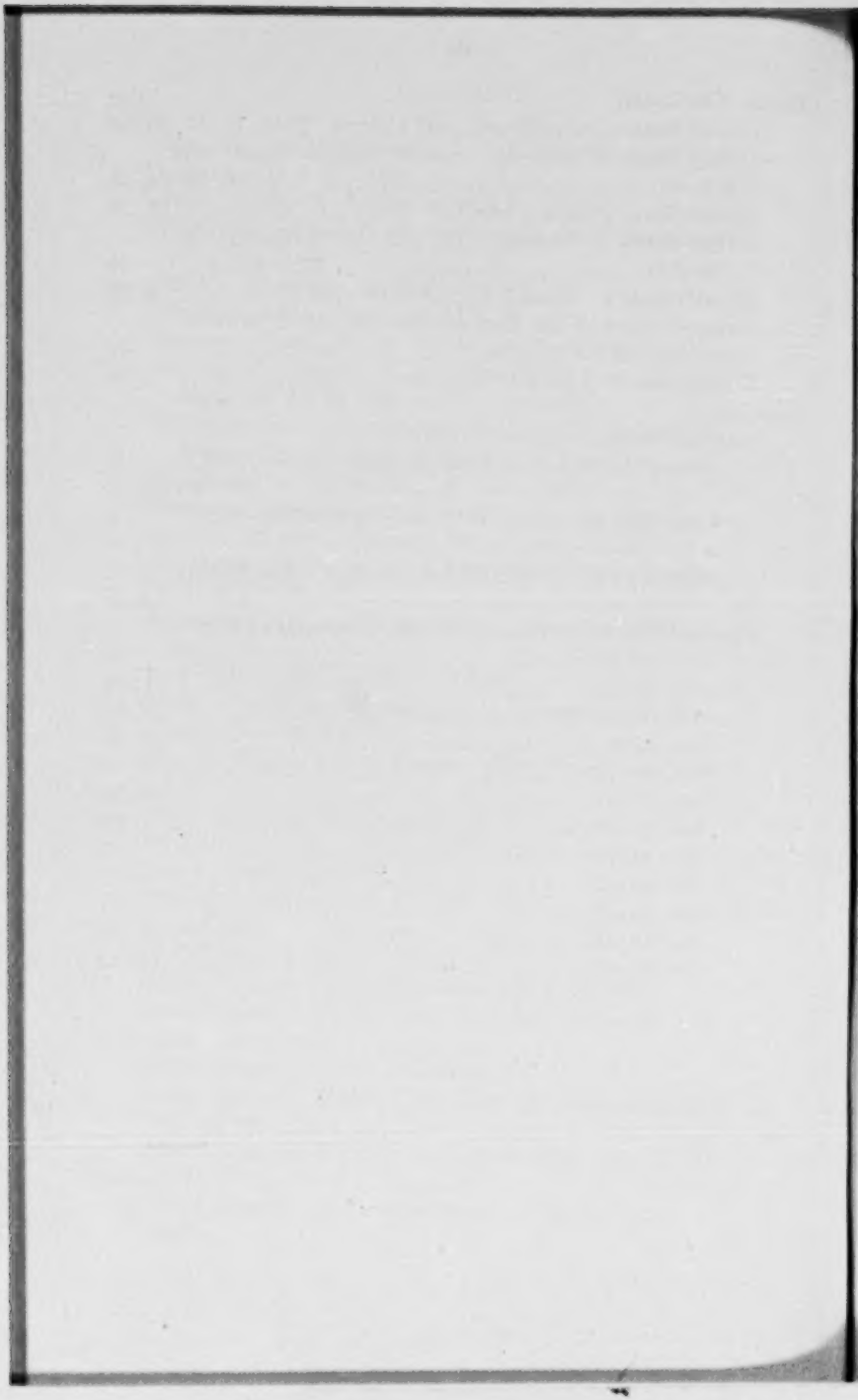
Cases:

	Page
Aquilino v. *United States*, 3 N.Y. 2d 511, certiorari granted, 359 U.S. 904	12, 13, 22, 23
Atlas Powder Co. v. *Denton*, 176 N.C. 426	20
Charlotte Pipe and Foundry Co. v. *Southern Aluminum Co.*, 172 N.C. 704	19
Clark v. *Edwards*, 119 N.C. 115	20
Commissioner v. *Stern*, 357 U.S. 39	25
Economy Pumps, Inc. v. *Woolworth Co.*, 220 N.C. 499	13
Fidelity & Deposit Co. v. *New York City Housing Auth.*, 241 F. 2d 142	23
Grier-Lowrance Construction Co. v. *Winston-Salem Journal Co.*, 198 N.C. 273	13
Hildebrand v. *Vanderbilt*, 147 N.C. 639	17
Illinois v. *Campbell*, 329 U.S. 362	15
Lester v. *Houston*, 101 N.C. 605	20
Morganton Hardware Co. v. *Morganton Graded Schools*, 151 N.C. 507	13, 19
Morganton Mfg. and Trading Co. v. *Andrews*, 165 N.C. 285	19
New York v. *Maclay*, 288 U.S. 290	25
Norfolk Building Supplies Co. v. *Elizabeth City Hospital Co.*, 176 N.C. 87	19
Orinoco Supply Co. v. *Eastern Star Home*, 163 N.C. 513	20
Payne v. *Flack*, 152 N.C. 600	20
Pinkston v. *Young*, 104 N.C. 102	20
Rose v. *Davis*, 188 N.C. 355	20
Schnepp v. *Richardson*, 222 N.C. 228	19, 20
United States v. *Acri*, 348 U.S. 211	15
United States v. *Bess*, 357 U.S. 51	13
United States v. *City of Greenville*, 118 F. 2d 963	14
United States v. *Colotta*, 350 U.S. 808, reversing 224 Miss. 33	14
United States v. *Gilbert Associates*, 345 U.S. 361	24
United States v. *Hulley*, 358 U.S. 66, reversing 102 So. 2d 599 (Fla.)	14
United States v. *Kings County Iron Works*, 224 F. 2d 232	12, 21, 22
United States v. *Liverpool & London Ins. Co.*, 348 U.S. 215	14, 15

COPY BOUND CLOSE IN CENTER

Cases—Continued

	Page
United States v. *New Britain*, 347 U.S. 81	7, 11, 12, 13, 15, 24
United States v. *Security Trust & Savings Bank*), 340 U.S. 47	7, 9, 14, 15, 24, 25
United States v. *Scovil*, 348 U.S. 218	14, 15, 24
United States v. *Vorreiter*, 355 U.S. 15, reversing 134 Col. 543	14
United States v. *Waddill Co.*, 323 U.S. 353	9, 23
United States v. *White Bear Brewing Co.*, 350 U.S. 1010, reversing 227 F. 2d 359	14
Widenhouse v. *Russ*, 234 N.C. 382	20
Statutes:	
Internal Revenue Code of 1954:	
Sec. 6321 (26 U.S.C. 1952 ed., Supp. V, Sec. 6321)	6, 11, 13, 27
Sec. 6322 (26 U.S.C. 1952 ed., Supp. V, Sec. 6322)	6, 12, 27
Sec. 6323 (26 U.S.C. 1952 ed., Supp., V, Sec. 6323)	9, 24, 27
General Statutes of North Carolina (Recompiled 1950):	
Sec. 44–1	28
Sec. 44–6	17, 28
Sec. 44–8	18, 29
Sec. 44–9	18, 29
Sec. 44–10	18, 30
Sec. 44–11	18, 30
Sec. 44–12	30
Sec. 44–38	31
Sec. 44–39	31
Sec. 44–40	31
Sec. 44–43	17, 32
Sec. 44–48	17, 32



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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 23

UNITED STATES OF AMERICA, PETITIONER

v.

DURHAM LUMBER CO., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The memorandum opinion of the District Court (R. 13–14) is not reported. The opinion of the Court of Appeals (R. 30–38) is reported at 257 F. 2d 570.

JURISDICTION

The judgment of the Court of Appeals was entered July 18, 1958. (R. 39.) By order of the Chief Justice, dated October 10, 1958, the time for filing a petition for certiorari was extended to and including December 15, 1958. (R. 41.) The petition for certiorari was filed on December 15, 1958, and was

granted on February 24, 1959. (R. 42; 359 U.S. 905.) The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, in the distribution of a fund determined by a state court judgment to be owing to the taxpayer, a "statutory right to payment" arising under state law is entitled to priority over a federal tax lien which arose before the "statutory right to payment" came into existence.

STATUTES INVOLVED

Pertinent provisions of the Internal Revenue Code of 1954 and of the General Statutes of North Carolina are set forth in the Appendix, *infra*, pp. 27–32.

STATEMENT

This case arises from bankruptcy proceedings instituted in the United States District Court for the Middle District of North Carolina. It involves the relative priority of federal tax liens and the claims of certain subcontractors to a fund recovered by the trustee in bankruptcy as the balance due, under a construction contract, to the bankrupt general contractor who, in turn, is indebted to the United States for unpaid withholding and unemployment insurance taxes. (R. 11.) The undisputed facts may be summarized as follows:

The taxpayer-bankrupts, Michael and Embree, were general contractors engaged in business at Durham, North Carolina. During the first part of 1954, they entered into a contract for the construction of buildings for certain persons hereinafter referred to as the

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"owners." The construction was completed on July 15, 1954. (R. 7–8.)

Shortly thereafter, on August 13, 1954, and November 22, 1954, federal withholding and unemployment insurance taxes were assessed against the taxpayers in the amounts of $4,017.53 and $3,254.73, respectively. A notice of lien for the former amount was filed in the office of the Register of Deeds of Durham County, North Carolina, on November 2, 1954. (R. 9.)

Respondent Dixie Concrete and Supply Company, a subcontractor, gave notice to the owners on January 12, 1955, of its claim against the taxpayers for $3,089.54. Respondent Durham Lumber Company, another subcontractor, gave notice to the owners of its claim for $366.93 in February, 1955.[1] (R. 9.) Neither respondent brought suit within the six-months period provided by North Carolina law for foreclosure of mechanic's liens. (R. 37.)

On January 18, 1955, the taxpayers were adjudicated bankrupts in the United States District Court. At that time there was an unpaid balance of $5,250 due from the owners to the taxpayers under the construction contract. The owners disputed the amount, however, and contended that nothing was due. (R. 7–8.)

The trustee in bankruptcy instituted suit against the owners in the state court, and obtained a jury verdict for $5,250. Judgment on that verdict was entered on June 7, 1956. (R. 8.)

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[1] A third subcontractor, Durham Brazing & Welding Company, gave notice of its claim to the owners on June 20, 1955. Five other subcontractors did not give notice to the owners. (R. 9.)

Shortly after this judgment was entered, the owners petitioned the bankruptcy court for permission to pay certain subcontractors of the bankrupts who had given the owners notice of their claims. Extensive negotiations were had among the trustee, the owners and the subcontractors, two of whom (Adams Concrete and Block Company ("Adams") and Nolan and Company ("Nolan")) had instituted suits against the owners in the state court. The owners filed a motion in the state court to reopen the proceedings brought by the trustees, in order to make the subcontractors parties to the action; and Nolan filed a petition in the District Court for permission to add the trustees in bankruptcy as a party to its action. Finally, under a compromise agreement approved by the District Court, the claims of Adams and Nolan were settled for a total of $465.65, with the understanding that this amount would be paid from the judgment obtained in the state court. The owners then paid to the trustees the judgment in the amount of $5,250, together with interest of $250. It was understood among the parties that their rights to this fund would be determined by the District Court in the same manner as if all parties were before the state court.[2] The Director of Internal Revenue was not a party to any of these proceedings. (R. 8–9, 10.)

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[2] The judgment of the state court required the owners to pay to the trustee in bankruptcy the balance due on the construction contract, transferred the liens of the several claimants to the fund so paid and discharged the owners from liability to any of the liens claimants named as defendants in that proceeding. (R. 24–27.)

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The referee in bankruptcy determined that the fund should first be applied toward paying the fees of the trustees and their attorneys, court costs and the compromise settlement with Adams and Nolan, in the total amount of $1,885.65 (leaving a balance in the fund of $3,614.35) (R. 9–10). Second priority was given to the tax claims of the United States, on the ground that the federal tax liens were prior to those of the three subcontractors who had given notice to the owners (R. 10). The balance of $790 remaining in the bankrupt estate (which included assets in addition to the amounts received from the owners) after payment of the federal tax claims (R. 7) was ordered distributed *pro rata* to the three subcontractors who had given notice of their claims to the owners. The remaining subcontractors who had not given notice were held not to have any liens on the proceeds (R.10).

On exceptions filed by the two subcontractors who are respondents here, the district court held in a memorandum opinion (R. 13–14) that their liens were entitled to priority over the tax liens of the United States, and modified the referee's order accordingly.[2a]

The Court of Appeals for the Fourth Circuit affirmed the order of the district court. It stated that, under North Carolina law, the subcontractor who notifies the owner of his claim has both a lien on the real property, which is superior to any lien of the general contractor, and also a "statutory right to payment" from the owner (R. 34, 37); that although the

[2a] The effect of the modification was to allow these two claims in full, thereby reducing the amount received by the United States from $7,272.26 (the amount of its liens) to $4,606.79 (R. 7, 14).

517028—59——2

Government's tax lien "is clearly entitled to priority over the general claims of subcontractors seeking payment out of the property or interests in property of the general contractor, to which the tax lien has attached" (R. 34), the subcontractors here were not "seek[ing] payment out of the properties of the general contractor which are subject to the tax lien" but were presenting claims "addressed to the owners" (R. 35); and that the subcontractors' "statutory right to payment" by the owners "is not extinguished by the tax lien on the property of the general contractor, whose only claim against the owners under the laws of North Carolina, is for so much of the construction price as will remain unpaid after the owners have deducted a sum sufficient to pay the subcontractors" (R. 37–38).

SUMMARY OF ARGUMENT

A. Section 6321 of the Internal Revenue Code of 1954 provides that, upon failure of any person to pay any tax due to the United States, the amount thereof "shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." Section 6322 of the Code provides that the liens "shall arise at the time the assessment is made * * *." The federal taxes were assessed against the taxpayers-contractors on August 13, 1954 and November 22, 1954, and under Section 6322 the tax liens were perfected on those dates. At the time the liens were perfected, there was an unpaid balance of $5,250 due to the contractors from the owners. This indebtedness plainly constituted "property" or "rights to property" of the contractors within the meaning of Section 6321, and

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the federal tax lien attached to this claim against the owners. The subcontractors did not give notice to the owners until January and February 1955—several months after the federal liens had attached and more than two months after one of such liens had been recorded. Under North Carolina law, the subcontractors had no enforceable claim against the owners until they had given notice. Thus, the subcontractors' right to proceed directly against the owners did not arise until several months after the federal tax liens had attached.

B. In determining priority between liens of the same seniority, the settled rule is that "the first in time is the first in right." *United States* v. *New Britain,* 347 U.S. 81, 85. Thus, even if the subcontractors had obtained perfected liens upon the owners' indebtedness to the contractor when they gave notice (which they did not), the federal liens would still have priority.

Furthermore, it is well settled that a federal tax lien has priority over a mechanic's lien which, even though recorded, is still inchoate in the sense that additional steps are required to perfect it. *United States* v. *Security Trust and Savings Bank,* 340 U.S. 47. Here the subcontractors never obtained fully choate perfected liens. Prior to giving notice, they did not even have a "statutory right to payment," much less a perfected lien. Even after giving notice, their lien was still inchoate, since further steps were required to perfect it.

C. The Court of Appeals, although recognizing that a federal tax lien has priority over a mechanic's lien

"when the two liens attach to the same property" (R. 32), held that since the subcontractors had a "statutory right to payment" directly from the owners, the owners' indebtedness to the contractor ceased to be property of the latter to which the federal lien attached. While North Carolina law does give a subcontractor the right to proceed directly against an owner to enforce his lien, in doing so the subcontractor is merely seeking to apply the owner's existing debt to the contractor to the satisfaction of his own claim against the latter. Under North Carolina law the subcontractor has an enforceable claim against the owner only to the extent of the latter's indebtedness to the contractor at the time that notice is given. Thus, in asserting a statutory right to payment against the owner, the subcontractor necessarily stands in the shoes of, and claims through, the contractor. The North Carolina statutes merely provide a procedure by which the subcontractor can satisfy his claim against the contractor directly out of the latter's claim against the owner. The subcontractor is subrogated to the contractor's claim against the owner, and that claim continues to be "property" of the contractor even though state law permits such property to be applied directly to the discharge of the latter's debts.

The subcontractors' argument here is but another formulation of the view, repeatedly rejected by this Court, that by the mere existence of an inchoate lien upon a taxpayer's property, "such goods severed themselves from the general and free assets of the [taxpayer] from which the claims of the United

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States were entitled to priority". *United States* v. *Waddill Co.*, 323 U.S. 353, 358–359. For whenever priority is sought for inchoate local liens over existing federal liens, it can always be argued that the effect of the inchoate lien is to remove the assets to which it applies from the taxpayer's property. In Section 6323 of the Internal Revenue Code, however, Congress has made the decision that only four categories of lienors are specifically excepted from the priority of federal tax liens—mortgagees, pledgees, purchasers and judgment creditors—and then only with respect to unrecorded liens. Since the subcontractors' "statutory right to payment" had not been reduced to judgment prior to either the attachment of both federal liens or the recording of one of them Section 6323 is inapplicable here.

D. The effect of the decision below, therefore, is to treat the inchoate lien subsequently created by the giving of notice as relating back to a date prior to the creation of the federal lien. But "the doctrine of relation back * * * [cannot] operate to destroy the realities of the situation." *United States* v. *Security Trust & Savings Bank*, 340 U.S. 47, 50. The realities of the situation here are that, at the time the federal liens attached, the subcontractors had not yet asserted their "statutory right to payment" by giving notice, and the full balance due under the contract was owing to the contractor; that the right to receive such balance was property of the contractor to which the federal lien attached; and that, by giving notice, the subcontractors acquired only an inchoate lien, and

upon property which was already encumbered by the prior perfected federal liens.

ARGUMENT

INTRODUCTION

This Court has consistently held that federal tax liens have priority over mechanic's liens where the federal lien attached first or where, even if it arose after the mechanic's lien, the latter was "inchoate" in the sense that additional steps were required to perfect it (see *infra,* pp. 13–15). In the instant case, the federal liens arose several months before the subcontractors' "statutory right to payment" came into being, and at a time when any liens they may have had were still inchoate. Under these settled principles, therefore, it would seem beyond question that the federal tax liens have priority.

However, the Court of Appeals, although recognizing the "priority of the Federal tax lien over a mechanic's lien when the two liens attach to the same property" (R. 32), ruled that it was here "confronted with a different situation" (*ibid*). It stated (R. 34–35) that it could not "ignore the facts that the tax lien reaches the properties of the general contractor, not those of the owners, and that the independent rights of the subcontractors [their "statutory right to payment"] are asserted against the owners and their properties, not against the taxpayer or its properties"; and that the "priority of the tax lien" on the taxpayer's property "is not to be extended to a like priority in the division or distribution of the properties of the taxpayer's debtor to which the tax

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lien does not reach." In short, the Court of Appeals held that, since North Carolina law gives a subcontractor priority over a contractor in obtaining payment from the owner, the owner's indebtedness to the contractor is not part of the latter's property to which the federal tax lien attaches.

We shall show, however, that both the federal lien and the "statutory right to payment" do relate "to the same property," namely, the owner's indebtedness to the contractor; and that the federal lien attached to this property before the subcontractor's claim against it came into being. This case, therefore, is one to which the settled rule that "the first in time is the first in right" (*United States* v. *New Britain*, 347 U.S. 81, 85) is applicable. We shall further show that the prior lien of the United States upon this property was not extinguished by the subcontractors' subsequent assertion of their statutory rights to proceed directly against the owners to satisfy their claim against the contractor.

FEDERAL TAX LIENS ON FUNDS DUE A CONTRACTOR FROM AN OWNER HAVE PRIORITY OVER SUBCONTRACTORS' STATUTORY RIGHTS TO PAYMENT WHICH HAD NOT ARISEN WHEN THE FEDERAL LIEN CAME INTO EXISTENCE AND WHICH, EVEN AFTER ASSERTION, CREATED ONLY INCHOATE LIENS

A. Prior to the assertion of the subcontractors' "statutory right to payment," the United States had obtained an effective lien upon the property here involved, *i.e.*, the contractor's claim against the owners

Section 6321 of the Internal Revenue Code of 1954 (Appendix, *infra*, p. 27) provides that if any person

liable to pay any tax neglects or refuses to pay such tax after demand, the amount thereof (together with any additions thereto) "shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." Section 6322 (Appendix, *infra*, p. 27) provides that, unless another date is specifically fixed by law, the lien "shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time." The federal taxes were assessed against the taxpayers on August 13, 1954 and November 22, 1954, respectively, and under Section 6322 the federal tax liens were "perfected" (*United States* v. *New Britain*, 347 U.S. 81, 84) on those dates.

At the time these liens arose, the construction work under the contract had been completed, and there was an unpaid balance due the contractor of $5,250. The fact that the owners disputed that this sum was owing is immaterial, for the subsequent state court judgment obtained by the trustee in bankruptcy against the owners conclusively established the indebtedness.

Under Section 6321 of the Code, the tax liens attached to "all property and rights to property, whether real or personal, belonging to" the taxpayers-contractors. Plainly, the existing indebtedness of the owners to the contractor constituted "property" or "rights to property" of the latter, and the lien therefore attached to the contractors' claim to this indebtedness. *United States* v. *Kings County Iron Works*, 224 F. 2d 232 (C.A. 2); *Aquilino* v. *United States*, 3 N.Y.

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2d 511, pending on writ of certiorari, No. 1, this Term; cf. *United States* v. *Bess*, 357 U.S. 51, 56.

The subcontractors did not give notice to the owners until January and February, 1955—several months after the federal liens had attached and more than two months after one of such liens had been recorded. It is settled, as the Court of Appeals recognized (R. 34), that under North Carolina law the subcontractors had no enforceable claim against either the owners or the real estate until they had given notice. *Grier-Lowrance Construction Co.* v. *Winston-Salem Journal Co.*, 198 N.C. 273; *Morganton Hardware Co.* v. *Morganton Graded Schools*, 151 N.C. 507; *Economy Pumps, Inc.* v. *Woolworth Co.*, 220 N.C. 499. Thus, however one may characterize the rights which North Carolina law gives subcontractors to proceed directly against the owners (see *infra*, pp. 17–23), it is undisputed that such rights did not here arise until several months after the federal tax liens had attached.

B. The earlier tax lien of the United States has priority over the subsequently arising "statutory right to payment"

1. In determining priority between liens of the same seniority, the settled rule is that "the first in time is the first in right." *United States* v. *New Britain*, 347 U.S. 81, 85. "Congress had this cardinal rule in mind when it enacted § 3670 [now Section 6321 of the 1954 Code], a schedule of priority not being set forth therein. Thus, the priority of each * * * lien contested here must depend on the time it attached to the property in question and became choate" (*id.*, p. 86).

As noted, the federal tax liens arose in August and November, 1954, and the subcontractors' "statutory right to payment" was not even asserted until January and February of the following year, when they first gave notice of their claims to the owners. Thus, even if the subcontractors had obtained fully perfected liens on the owners' indebtedness to the contractor by giving notice (which they did not, see *infra*, p. 15), such liens would still be subordinate to those of the United States under the settled principle that "the first in time is the first in right." *United States* v. *Hulley*, 358 U.S. 66, summarily reversing 102 So. 2d 599 (Fla.) (federal tax lien has priority over subsequently arising mechanic's lien); cf. *United States* v. *Scovil*, 348 U.S. 218; *United States* v. *City of Greenville*, 118 F. 2d 963, 966 (C.A. 4).

2. Even where the mechanic's lien was recorded before the federal lien arose, the federal lien has priority if additional steps are necessary to perfect the mechanic's lien. *United States* v. *Security Trust & Savings Bank*, 340 U.S. 47; *United States* v. *Colotta*, 350 U.S. 808, summarily reversing 224 Miss. 33; *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010, summarily reversing 227 F. 2d 359 (C.A. 7th); *United States* v. *Vorreiter*, 355 U.S. 15, summarily reversing 134 Col. 543. The rationale of this rule, as explained in the *Security Trust* case, is that the effect of a local statutory lien in relation to the federal tax lien is always a federal question; that a prior inchoate lien under state law cannot take preference over a subsequent federal tax lien; and that the local lien remains inchoate, and unperfected in

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this sense, while it is "contingent upon taking subsequent steps for enforcing it" (340 U.S., p. 51). This rationale was reaffirmed in *United States* v. *Acri,* 348 U.S. 211 (attachment lien), *United States* v. *Liverpool & London Ins. Co.,* 348 U.S. 215 (garnishment lien), and *United States* v. *Scovil,* 348 U.S. 218 (landlord's distress lien), where the federal lien was held to have priority. See also *United States* v. *New Britain,* 347 U.S. 81, 86.

In the instant case, it is clear that the subcontractors never obtained fully choate perfected liens on the owners' indebtedness to the contractor. Prior to giving notice, they did not even have a "statutory right to payment" (see *supra,* p. 13), much less a perfected lien. Even after giving notice, their lien was still inchoate, since further steps were necessary to perfect it. The subcontractors had to initiate and successfully prosecute an action based on their "statutory right to payment," and the amount of such payment had to be fixed.[3] Cf. *Illinois* v. *Campbell,* 329 U.S. 362, 375; *United States* v. *New Britain,* 347 U.S. 81, 86. Their interest, therefore, was no greater than the other inchoate liens which have been held subordinate to federal tax liens (*supra,* pp. 14–15).

C. The contractor's claim against the owners did not cease to be property of the contractor (to which the federal tax lien

[3] In any suit by the subcontractors against the owners, the latter could have asserted any defense they might have as against the contractors (see *infra,* pp. 19–20). Indeed, in this very case the owners denied any liability to the contractors for the balance due—a claim which the state court rejected (see *supra,* p. 3).

attached) because the subcontractors could assert a "statutory right to payment" directly against the owners

The only theory upon which the subcontractors could have priority over the federal tax lien is that the mere existence of their inchoate "statutory right to payment" converted the contractor's claim against the owners into a direct obligation by the latter to the subcontractors; and that the contractor's claim, therefore, ceased to be "property" of the contractor to which the federal lien could attach. This, apparently, was the view of the Court of Appeals. It stated (R. 34, 35) that "the independent rights of the subcontractors are asserted against the owners and their properties, not against the taxpayer or its properties * * * the subcontractors here * * * do not seek payment out of the properties of the general contractor which are subject to the tax lien. Their claims are addressed to the owners."[4]

We shall show, however, that the North Carolina "statutory right to payment" is not an "independent cause of action against the owner" in the sense that in asserting it the subcontractors "do not claim through or in the right of the taxpayer" (R. 34, 35). It is a method by which the owner's indebtedness to the contractor is applied to satisfy the latter's indebtedness to the subcontractors. Since the "statutory right to payment" exists only to the extent that

[4] See, also, the court's statement (R. 37–38) that the contractor's "only claim against the owners under the laws of North Carolina, is for so much of the construction price as will remain unpaid after the owners have deducted a sum sufficient to pay the subcontractors."

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the contractor has an enforceable claim against the owner (see *infra,* pp. 19–20), the subcontractors necessarily stand in the shoes of, and claim through, the former. Their position basically is that of subrogees of the contractor's claim against the owners, and that claim is just as much "property" of the contractor as any other chose in action.

1. Under North Carolina law, all subcontractors furnishing labor or material for building, repairing or altering houses shall, upon giving notice to the owner of the property, "have a lien on said house and real estate for the amount of such labor done or material furnished * * * which may be enforced as other liens in this chapter" (Section 44–6, Appendix, *infra,* p. 28). This lien on the realty, however, "is extinguished if the subcontractor does not commence an action to enforce it within six months after the notice * * *" (R. 33; Section 44–43, 44–48(4), Appendix, *infra,* p. 32; *Hildebrand* v. *Vanderbilt,* 147 N.C. 639). In this case, no action to enforce their liens on the realty was brought by the subcontractors within six months of giving notice, and those liens were therefore extinguished.

North Carolina law further provides for satisfaction of the subcontractors' claims against the contractor out of the owner's indebtedness to the latter. The contractor has the "duty * * * before receiving any part of the contract price, as it may become due," to furnish the owner with an itemized statement of any amounts due to subcontractors; upon the delivery of such statement "it is the duty of the owner to retain from the money then due the contractor a sum not

exceeding the price contracted for, which will be sufficient to pay" such subcontractors, and which amount "the owner shall pay directly" to the latter (Section 44–8, Appendix, *infra,* p. 29). Furthermore, the subcontractor himself may give notice of his claim by giving the owner an itemized statement (Section 44–9, Appendix, *infra,* pp. 29–30). If, upon giving of such notice, the owner refuses to retain, "out of the amount due the contractor under the contract," a sum sufficient to pay the subcontractor's claim, "the claimant may proceed to enforce his lien * * *" (*ibid.*). The sums due a subcontractor as shown by the itemized statement "shall be a lien" on the construction (Section 44–10, Appendix, *infra,* p. 30), and after notice has been given by the subcontractor, "no payment to the contractor shall be a credit on or a discharge of the lien herein provided for" (Section 44–9, Appendix, *infra,* p. 30). Finally, it is provided that if the owner's indebtedness to the contractor is insufficient to pay the claims of all subcontractors who have given notice, the owner shall distribute the amount owing *pro rata* among the claimants (Section 44–11, Appendix, *infra,* p. 30).

The effect of the foregoing provisions is, as the Court of Appeals stated (R. 34), to give a subcontractor two different methods of obtaining payment of his claim against the contractor. (1) He has a "lien upon the improved real estate" which is extinguished if an action to enforce it is not commenced within six months. (2) He has "an independent cause of action against the owner, maintainable in his own name and in his own right," which he can institute

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within the statutory period of limitations. However, both of these rights come into being only after the subcontractor has given notice to the owner (R. 34; see *supra*, p. 13). Furthermore, his "independent cause of action" against the owner "is dependent upon acquiring a lien on the property by giving the notice to the owner; and if no lien on the property is or can be acquired, no duty or obligation is imposed upon the owner by giving the notice" (*Charlotte Pipe and Foundry Co.* v. *Southern Aluminum Co.*, 172 N.C. 704, 707).[5]

2. The Court of Appeals was of the view that since the North Carolina Supreme Court has described the owner's duty to pay the subcontractor as "an independent and primary obligation created by statute" (*Schnepp* v. *Richardson*, 222 N.C. 228, 229), the contractor's claim against the owner, to the extent that it is subject to reduction by such payment, is no longer part of the property of the contractor. But this conclusion overlooks the crucial fact that in proceeding against the owner the subcontractor is merely seeking to apply the owner's existing debt to the contractor to the satisfaction of his own claim against the latter. For under North Carolina law the owner

[5] The North Carolina statutes themselves refer to the "statutory right to payment" as an action to enforce a lien (see *supra*, pp. 17–18), and the North Carolina Supreme Court regularly has characterized the right of action as based upon a lien (see, *e.g.*, *Morganton Hardware Co.* v. *Morganton Graded Schools*, 151 N.C. 507; *Morganton Mfg. and Trading Co.* v. *Andrews*, 165 N.C. 285; *Charlotte Pipe and Foundry Co.* v. *Southern Aluminum Co.*, 172 N.C. 704; *Norfolk Building Supplies Co.* v. *Elizabeth City Hospital Co.*, 176 N.C. 87).

is liable to the subcontractor "only to the extent of the unexpended contract price still retained by him" (*Schnepp* v. *Richardson, supra*); the legislation was designed to enable subcontractors "to secure, in order to [obtain] the payment of what is due them, the indebtedness due from the debtor to the contractor" (*Lester* v. *Houston,* 101 N.C. 605, 610). It has been repeatedly held that the subcontractor has an enforceable claim against the owner only to the extent of the latter's indebtedness to the contractor at the time that notice is given.[6]

The North Carolina legislation merely provides a procedure by which the subcontractor may satisfy his claim against the contractor directly out of the latter's claim against the owner. But the fact that the state gives the subcontractor such a method of enforcing his lien does not convert the owner's contractual obligation to the contractor into a direct and independent indebtedness to the subcontractor. To the contrary, the very existence of an enforceable claim by the subcontractor against the owner presupposes, and is dependent upon, a valid claim by the contractor for the balance due under the contract. Unless the contractor has such a claim, the subcontractor cannot

[6] *Lester* v. *Houston*, 101 N.C. 605; *Widenhouse* v. *Russ*, 234 N.C. 382; *Schnepp* v. *Richardson*, 222 N.C. 228; *Atlas Powder Co.* v. *Denton*, 176 N.C. 426; *Rose* v. *Davis*, 188 N.C. 355; *Payne* v. *Flack*, 152 N.C. 600; *Pinkston* v. *Young*, 104 N.C. 102; *Clark* v. *Edwards*, 119 N.C. 115; *Orinoco Supply Co.* v. *Eastern Star Home*, 163 N.C. 513. In the typical case, the contractor defaults before completing the work, and the owner's additional expense in finishing the job offsets any balance otherwise due the contractor. See, *e.g.*, *Clark* v. *Edwards* and *Schnepp* v. *Richardson, supra.*

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acquire any rights against the owner by giving notice. Such claim continues to be "property" of the contractor even though state law permits it to be directly applied to the discharge of the latter's debts.

In *United States* v. *Kings County Iron Works,* 224 F. 2d 232 (C.A. 2), the court rejected the contention that, under similar provisions of the New York state lien law, a contractor's claim against an owner ceased to be property of the contractor for federal tax purposes. As the court there pointed out (p. 234), New York provides a "mechanic's lienor with two separate and distinct forms of protection for its claim. One of these is the ordinary lien on the real estate improved by * * * [his] services * * *. The other * * * is an interest in the funds which the owner of the improved real estate owes the prime contractor. These funds are deemed a trust fund for the payment of subcontractors, N.Y. Lien Law §§ 13(7), 36–a, and the trust fund arises when the subcontractor performs his services."

In holding that a federal tax lien had priority over a subsequently filed mechanic's lien against funds due to the contractor from the owner, the Second Circuit rejected the argument that "the trust fund given by these statutory provisions * * * divests the contractor of his property interest in his chose in action against the property owner * * * for federal tax purposes" (p. 235). The court stated (pp. 235–236):

> Until and unless the mechanic's lienor perfects his rights to the trust fund by filing a timely civil action in accordance with § 75 of N.Y. Lien Law, the contractor retains a paramount

> interest in the property in question, so that the debt belongs to him and is subject to federal levy as such.

The court further held (p. 236) that "until such a suit is brought, the fact and the amount of the final mechanic's lien remain uncertain"; and that "for federal tax purposes the state lien is general and inchoate until such time."

The court's reasoning, we submit, is equally applicable to this case. Here, too, the State of North Carolina gives the materialman "two separate and distinct forms of protection" for his claim: the normal lien on the real estate and "an interest in the funds which the owner of the improved real estate owes the prime contractor". But until the subcontractor "perfects his rights" to this fund by giving notice of his claim to the owner and taking the further steps necessary to obtain a choate lien (see *supra*, p. 15), "the contractor retains a paramount interest in the property in question, so that the debt belongs to him and is subject to federal levy as such." See, also, *Aquilino* v. *United States*, 3 N.Y. 2d 511, pending on writ of certiorari, No. 1, this Term, where the New York Court of Appeals similarly held that an owner's indebtedness to a contractor is "property" to which a federal tax attaches; and that such lien has priority over a subsequently created mechanic's lien. The court ruled (3 N.Y. 2d at 516) that "the provision in this state's Lien Law * * * that funds received by a contractor from the owner for the improvement of real property shall be deemed 'trust funds' for the payment of subcontractors * * * may

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not be construed to affect the rights of the government or the priority of its tax lien."[7]

3. Basically, the subcontractors' argument here is but another formulation of the view, repeatedly rejected by this Court, that by the mere existence of an inchoate lien upon a taxpayer's property, "such goods severed themselves from the general and free assets of the * * * [taxpayer] from which the claims of the United States were entitled to priority". *United States* v. *Waddill Co.*, 323 U.S. 353, 358–359. For in any case in which priority is sought for inchoate local liens over existing federal liens, it can always be argued that the effect of the inchoate lien is to remove the assets to which it applies from the taxpayer's property.

Congress, however, has made the decision that in such cases the federal lien has priority. Only four

[7] The reliance of the court below (R. 36–37) upon *Fidelity & Deposit Co.* v. *New York City Housing Auth.*, 241 F. 2d 142 (C.A. 2), is misplaced. There, the taxpayer-contractor breached its contract with the owner— *i.e.*, a special provision requiring payment of the laborers and materialmen as a condition precedent to receipt of any part of the contract price—and the Second Circuit held that accordingly there was no debt due to the taxpayer-contractor and that the taxpayer-contractor had no right to which the federal lien could attach. But it reached that result solely on the ground that, as a matter of state contract law, the taxpayer-contractor had no contractual right to which the federal lien could attach (pp. 144–145). The Second Circuit distinguished its earlier decision in the *Kings County* case, *supra*, on the ground that there it was "not disputed * * * that the taxpayer-contractor * * * was owed money (having performed his promises under a contract) by the owner" (241 F. 2d at 145); and it stated (*ibid.*) that *Kings County* held that for federal tax purposes the "trust fund" created by New York law resulted only in a lien which was junior to the federal tax lien.

categories of lienors are specifically excepted by Section 6323 of the Code (Appendix *infra,* p. 27) from the priority of the federal lien—mortgagees, pledgees, purchasers and judgment creditors—and then only with respect to unrecorded liens. Since the subcontractors' "statutory right to payment" had not been reduced to judgment prior to either the attachment of both federal liens or the recording of one of them, Section 6323 is inapplicable here.[8] The decision below thus elevates the holders of a mere statutory right to payment, not even asserted at the time the federal lien arose, to a status which is not even enjoyed by mortgagees, pledgees, purchasers, and judgment creditors. It is clear, however, that Congress did not "intend * * * antecedent federal tax liens to rank behind any but the specified categories of interests set out" in Section 6323. *United States* v. *New Britain,* 347 U.S. 81, 88.

D. Giving the subcontractors priority would result in extinguishing an existing federal lien through the rejected doctrine of "relation back"

Since the contractor's claim against the owner was "property" of the former, and since the subcontractors had no security interest in that property at the

[8] This Court has made it clear that the four categories of persons entitled to protection under Section 6323 are to be defined according to the conventional meaning of the terms used in the statute. See *United States* v. *Gilbert Associates,* 345 U.S. 361, 364–365 ("judgment creditor"); *United States* v. *Scovil,* 348 U.S. 218, 221 ("purchaser"). See also *United States* v. *Security Tr. & Sav. Bk.,* 340 U.S. 47, 52 (concurring opinion of Mr. Justice Jackson).

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time the federal lien attached, the effect of the decision below is to treat the unperfected lien subsequently created by the giving of notice as relating back to a date prior to the creation of the federal lien. But "the doctrine of relation back * * * [cannot] operate to destroy the realities of the situation." *United States* v. *Security Trust & Savings Bank,* 340 U.S. 47, 50; *New York* v. *Maclay,* 288 U.S. 290, 294. The realities of the situation here are that at the time the federal liens attached, the subcontractors had not yet asserted their "statutory right to payment" by giving notice, and the full balance due under the contract was owing to the contractor. The right to receive such balance was, as we have shown, property of the contractor to which the federal lien attached. Thus, when the inchoate liens in favor of the subcontractors were created by giving notice, the property to which such liens attached was already encumbered by the perfected federal liens. The rights which the subcontractors acquired, therefore, were necessarily subject to the prior rights of the United States. "[S]tate law may not destroy a [federal] tax lien which has attached * * *." *Commissioner* v. *Stern,* 357 U.S. 39, 47.

Thus, however one may characterize the interest of the subcontractors at the time the federal lien attached—whether as inchoate lienors or as the holders of a possible "statutory right to payment" to be asserted against the owners—that interest remains nonetheless subordinate to the tax lien of the United States.

CONCLUSION

The judgment of the Court of Appeals should be reversed, and the order of the referee in bankruptcy should be reinstated.

Respectfully submitted,

J. LEE RANKIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
DANIEL M. FRIEDMAN,
Assistant to the Solicitor General.
A. F. PRESCOTT,
MYRON C. BAUM,
Attorneys.

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APPENDIX

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 1952 ed., Supp. V, Sec. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, and the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 1952 ed., Supp. V, Sec. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITOR.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under State or Territorial Laws.*—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With Clerk of District Court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; * * *

* * * * *

(26 U.S.C. 1952 ed., Supp. V, Sec. 6323.)

General Statutes of North Carolina (Recompiled 1950):

SEC. 44–1. *On buildings and property, real and personal.*—Every building built, rebuilt, repaired or improved, together with the necessary lots on which such building is situated, and every lot, farm or vessel, or any kind of property, real or personal, not herein enumerated, shall be subject to a lien for the payment of all debts contracted for work done on the same, or material furnished.

* * * * *

SEC. 44–6. *Lien given subcontractors, etc., on real estate.*—All subcontractors and laborers who are employed to furnish or who do furnish labor or material for the building, repairing or altering any house or other improvement on real estate, have a lien on said house and real estate for the amount of such labor done or material furnished, which lien shall be preferred to the mechanic's lien now provided by law, when notice thereof shall be given as hereinafter provided, which may be enforced as other liens in this chapter, except where it is otherwise provided; but the sum total of all the liens due subcontractors and materialmen shall not exceed the amount due the original contractor at the time of notice given.

* * * * *

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SEC. 44–8. *Statement of contractor's indebtedness to be furnished to owner; effect.*—When any contractor, architect or other person makes a contract for building, altering or repairing any building or vessel, or for the construction or repair of a railroad, with the owner thereof, it is his duty to furnish to the owner or his agent, before receiving any part of the contract price, as it may become due, an itemized statement of the amount owing to any laborer, mechanic or artisan employed by such contractor, architect or other person, or to any person for materials furnished, and upon delivery to the owner or his agent of the itemized statement aforesaid, it is the duty of the owner to retain from the money then due the contractor a sum not exceeding the price contracted for, which will be sufficient to pay such laborer, artisan or mechanic for labor done, or such person for material furnished, which said amount the owner shall pay directly to the laborer, mechanic, artisan or person furnishing materials. The owner may retain in his hands until the contract is completed such sum as may have been agreed on between him and the contractor, architect or other person employing laborers, as a guaranty for the faithful performance of the contract by such contractor. When such contract has been performed by the contractor such fund reserved as a guaranty shall be liable to the payment of the sum due the laborer, mechanic or artisan for labor done, or the person furnishing the materials as hereinbefore provided.

SEC. 44–9. *Subcontractors, laborers, and materialmen may notify owner of claim; effect.*—Any subcontractor, laborer, mechanic, artisan, or person furnishng materials, who claims the lien provided for in this article for labor on, or materials furnished for, any building, vessel, railroad, or real estate, may give notice to the owner, agent or lessee who makes the contract

for the labor or materials, of the amount due by the contractor to such claimant. The notice shall be in the form of an itemized statement of the amount due, except where the contract is entire for a gross sum and cannot be itemized. Upon the delivery of the notice to the owner, agent, or lessee, the claimant is entitled to all the liens and benefits conferred by law in as full a manner as though the statement were furnished by the contractor. If the said owner, agent or lessee refuses or neglects to retain, out of the amount due the contractor under the contract, a sum not exceeding the price contracted for which will be sufficient to pay such claimant, then the claimant may proceed to enforce his lien, and after such notice is given no payment to the contractor shall be a credit on or a discharge of the lien herein provided for.

SEC. 44–10. *Sums due by statement to constitute lien.*—The sums due to the laborer, mechanic or artisan for labor done, or due the person furnishing materials, as shown in the itemized statement rendered to the owner, shall be a lien on the building, vessel or railroad built, altered or repaired, without any lien being filed before a justice of the peace or the superior court.

SEC. 44–11. *Where sums due contractor from owner insufficient; payment pro rata.*—If the amount due the contractor by the owner is insufficient to pay in full the laborer, mechanic or artisan, for his labor, and the person furnishing materials, for materials furnished, it is the duty of the owner to distribute the amount pro rata among the several claimants, as shown by the itemized statement furnished the owner, or of which notice has been given the owner by the claimant.

* * * * *

SEC. 44–12. *Contractor failing to furnish statement, or not applying owner's payments to laborer's claims, misdemeanor.*—If any contrac-

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tor or architect shall fail to furnish to the owner an itemized statement of the sums due to every one of the laborers, mechanics or artisans employed by him, or the amount due for materials, before receiving any part of the contract price, he shall be guilty of a misdemeanor. If any contractor shall fail to apply the contract price paid him by the owner or his agent to the payment of bills for labor and material, he shall be guilty of a misdemeanor and upon conviction thereof shall be fined or imprisoned, or both, at the discretion of the court.

* * * * *

SEC. 44–38. *Claim of lien to be filed; place of filing.*—All claims against personal property, of two hundred dollars and under, may be filed in the office of the nearest justice of the peace; if over two hundred dollars or against any real estate or interest therein, in the office of the superior court clerk in any county where the labor has been performed or the materials furnished; but all claims shall be filed in detail, specifying the materials furnished or labor performed, and the time thereof. If the parties interested make a special contract for such labor performed, or if such material and labor are specified in writing, in such cases it shall be decided agreeably to the terms of the contract, provided the terms of such contract do not affect the lien for such labor performed or materials furnished.

SEC. 44–39. *Time of filing notice.*—Notice of lien shall be filed as hereinbefore provided, except in those cases where a shorter time is prescribed, at any time within six months after the completion of the labor or the final furnishing of the materials, or the gathering of the crops.

* * * * *

SEC. 44–40. *Date of filing fixes priority.*—The liens created and established by this chapter shall be paid and settled according to the prior-

ity of the notice of the lien filed with the justice or the clerk.

* * * * *

SEC. 44–43. *Action to enforce lien.*—Action to enforce the lien created must be commenced in the court of a justice of the peace, and in the superior court, according to the jurisdiction thereof, within six months from the date of filing the notice of the lien. But if the debt is not due within six months, but becomes due within twelve months, suit may be brought or other proceedings instituted to enforce the lien in thirty days after it is due.

SEC. 44–48. *Discharge of liens.*—All liens created by this chapter may be discharged as follows:

* * * * *

4. By a failure of the claimant to commence an action for the enforcement of the lien within six months from the notice of lien filed.

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INDEX

Page

Question presented 1

Statutes involved 2

Summary of Argument 2

Argument:

Introduction 3

A Federal Tax Lien on the "Property" or "Rights to Property" of a Contractor Does Not Extinguish Private Rights and Liabilities as Between Persons Who Do Not Claim By, Through or In Place of the Contractor. 3

A. State law creates legal interests in property to which Federal tax liens may attach. 3

B. The contractor, before being entitled to receive any payment from the owner, must furnish the owner a statement. 4

C. Subcontractors may protect their right to payment by giving notice directly to the owner. ... 4

D. The obligation of the owners to the subcontractors is the primary obligation. 5

E. The appellees do not seek payment from the delinquent taxpayer, but from the owner. 5

Conclusion 7

CITATIONS

Cases:

Campbell v. Hall, 187 N.C. 464, 121 S.E. 761..... 5

Charlotte Pipe & Foundry Co. v. Southern Aluminum Co., 172 N.C. 704, 90 S.E. 923 5

Erie R.R. v. Tompkins, 304 U.S. 64.....3, 4

Fidelity & Deposit Co. v. New York Housing Authority, 241 F. 2d 142 (C.A.2, 1957)..... 4

Guilford Lumber Mfg. Co. v. Holladay, 178 N.C. 417, 100 S.E. 597 .....4, 5

Hildebrand v. Vanderbilt, 147 N.C. 639, 61 S.E. 620.. 5

Morgan v. Commissioners, 309 U.S. 78.....4, 6

Perry v. Swanner, 150 N.C. 141, 63 S.E. 611..... 4

Schnepp v. Richardson, 222 N.C. 228, 22 S.E.2d 555.. 5

United States v. Bess, 357 U.S. 51.....4, 6

Cases—Continued:

Page

United States v. Colotta, 350 U.S. 808 6

United States v. Vorreiter, 355 U.S. 15 6

United States v. White Bear Brewing Co., 350 U.S. 1010 6

U.S.F.&G. Co. v. Triborough Bridge Authority, 297 N.Y. 31, 74 N.E.2d 226 4

Statutes:

Internal Revenue Code of 1954:
Sec. 6321 (26 U.S.C. 1952 ed., Supp. V, Sec. 6321) .. 3

General Statutes of North Carolina (Recompiled 1950):
Sec. 44-6 5

Sec. 44-8 4

Sec. 44-9 ..... 4, 5

Sec. 44-12 4

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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 23

UNITED STATES OF AMERICA, PETITIONER

v.

DURHAM LUMBER COMPANY, a Corporation, and GEORGE H. CARTER, JR., formerly Trading as DIXIE CONCRETE AND SUPPLY COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENTS

QUESTION PRESENTED

Whether Federal Tax Lien enlarges the property rights or rights to property of a defaulting taxpayer, thereby extinguishing private rights and liabilities as between persons who do not claim by or through or in place of the defaulting taxpayer.

STATUTES INVOLVED

Statutes involved appear in the record at the following pages: 1-5, 16, 17.

SUMMARY OF ARGUMENT

A. Legal interests are created by state law. Section 6321 of the Internal Revenue Code of 1954 provides that, upon the failure of any person to pay any tax due to the United States, the amount thereof "shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." It is therefore necessary that we refer to the property laws of the State of North Carolina for the purpose of determining the nature of the "property" and "rights to property" existing under the circumstances in this case.

B. Under the property laws of the State of North Carolina, the contractor (the defaulting taxpayer here) is required to furnish a list of his subcontractors and the amounts due each before he receives any payment, and it is the duty of the owner to withhold said amounts and pay them directly to the said subcontractors.

C. The subcontractors are given the opportunity to protect their right to payment (which right is superior to any the contractor may have) by giving notice to the owner.

D. The obligation of the owner to the subcontractor is primary, and his obligation to the contractor is secondary.

E. The subcontractors do not seek payment out of the property of the contractor (delinquent taxpayer); their claims are addressed to the owner.

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ARGUMENT

INTRODUCTION

This Court has held that, except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. This is true whether the law of the State is declared by the Legislature, by statute or by the highest court in a decision. *Erie R.R. v. Tompkins*, 304 U.S. 64.

The Court of Appeals in this case recognized the "priority of the Federal tax lien over a mechanic's lien when they attach to the same property" (R. 32) and correctly pointed out that here we have a "different situation" (*ibid*).

We shall show that the Court of Appeals properly applied the law of the United States and of the State of North Carolina to the facts as they appear in the record.

A FEDERAL TAX LIEN ON THE "PROPERTY" OR "RIGHTS TO PROPERTY" OF A CONTRACTOR DOES NOT EXTINGUISH PRIVATE RIGHTS AND LIABILITIES AS BETWEEN PERSONS WHO DO NOT CLAIM BY, THROUGH OR IN PLACE OF THE CONTRACTOR.

A. State law creates legal interests in property to which Federal tax liens may attach.

Section 6321 of the Internal Revenue Code of 1954 (R. 1) provides that, upon the failure of any person to pay any tax due to the United States, the amount thereof "shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." It is clear under the decisions of this Court that the Internal Revenue Code does not create property interests or

rights to property, but that is a matter for State law. *Erie R.R. v. Tompkins* (*supra*); *Morgan v. Commissioners*, 309 U.S. 78; *United States v. Bess*, 357 U.S. 51. It is therefore necessary that we examine State law for the purpose of determining the nature of the property or interests in property under the circumstances here existing. *United States v. Bess* (*supra*); *U.S.F.&G. Co. v. Triborough Bridge Authority*, 297 N.Y. 31; *Fidelity & Deposit Co. v. New York City Housing Authority*, 241 F.2d 142, C.A. 2 (1957).

B. The contractor, before being entitled to receive any payment from the owner, must furnish the owner a statement.

Under the property laws of the State of North Carolina, a general contractor (here the defaulting taxpayer), before being entitled to receive any payment from the owner, is required to file with said owner a statement of all sums due subcontractors, and the owner is required to pay said sums directly to the subcontractors, N.C. G.S. §44-8 (R. 3); *Guilford Lumber Mfg. Co. v. Holladay*, 178 N.C. 417, 100 S.E. 597; *Perry v. Swanner*, 150 N.C. 141, 63 S.E. 611, and the failure to furnish such statement is a misdemeanor, N.C. G.S. §44-12 (R. 16).

C. Subcontractors may protect their right to payment by giving notice directly to the owner.

By statute, the subcontractors are given the opportunity to protect their right to payment by giving notice directly to the owner. When the subcontractor delivers the itemized statement to the owner "the claimant is entitled to all the liens and benefits conferred by law in as full a manner as though the statement were furnished by the contractor." N.C. G.S. §44-9 (R. 3).

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The appellees here gave notice to the owners (R. 5), and the owners were required to make payments to the subcontractors in preference to the contractor. *Hildebrand v. Vanderbilt*, 147 N.C. 639, 61 S.E. 620; *Charlotte Pipe & Foundry Co. v. Southern Aluminum Co.*, 172 N.C. 704, 90 S.E. 923; *Guilford Lumber Mfg. Co. v. Holladay* (*supra*); *Campbell v. Hall*, 187 N.C. 464, 121 S.E. 761; *Schnepp v. Richardson*, 222 N.C. 228, 22 S.E.2d 555.

D. The obligation of the owners to the subcontractors is the primary obligation.

Under the statutes and decisions of North Carolina, the subcontractor who notifies the owner of his claim has a lien superior to any lien the general contractor may obtain and an independent cause of action against the owner that he may maintain in his own name and right, without regard to time limitations, to enforce the lien. The owner may not avoid or reduce his liability to the subcontractors by any payment to the contractor. The obligation of the owner to the subcontractor is the primary obligation, and the obligation to the contractor is secondary. *Hildebrand v. Vanderbilt* (*supra*); *Charlotte Pipe & Foundry Co. v. Southern Aluminum Co.* (*supra*); *Guilford Lumber Mfg. Co. v. Holladay* (*supra*); *Campbell v. Hall* (*supra*); *Schnepp v. Richardson* (*supra*), N.C. G.S. 44-6 (R. 2) and 44-9 (R. 3).

E. The appellees do not seek payment from the delinquent taxpayer, but from the owner.

We should not ignore the fact that the tax lien reaches the property of the contractor, but not the property of the owners, and that here the subcontractors are asserting their independent rights against the owners and are not asserting any rights against the contractor. This case does not involve the priority

of liens but rather the more basic fact of whether or not the Federal Internal Revenue Code creates property rights, thereby obtaining an interest superior to that held by the contractor (the defaulting taxpayer).

This Court, when squarely presented this problem, has repeatedly held that this was not the result of the Federal Revenue Acts. *United States v. Bess* (*supra*); *Morgan v. Commissioners* (*supra*).

This case is not inconsistent with the cases of *United States v. Colotta*, 350 U.S. 808, summarily reversing 79 So.2d 474 (Miss.); *United States v. White Bear Brewing Co.*, 350 U.S. 1010, summarily reversing 227 F.2d 359 (C.A. 7th); *United States v. Vorreiter*, 355 U.S. 15, summarily reversing 134 Colo. 543, for the reason that these were cases involving priority of liens. The instant case does not involve priority of liens but involves whether or not the filing of a tax lien in favor of the United States imposes a lien on the property and rights to property of the defaulting taxpayer or whether, as is argued by the United States in this case, legal interests superior to the interests of the defaulting taxpayer shall be swept aside by the mere filing of the Federal tax lien, thereby in effect creating in the United States legal interests superior to those held by the defaulting taxpayer.

It is respectfully submitted that the tax liens on the property of the defaulting taxpayer do not and should not extinguish private rights and liabilities as between other persons who do not claim by or through or in place of the defaulting taxpayer.

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CONCLUSION

The decision of the District Court and the Court of Appeals for the Fourth Circuit is good law and should be affirmed.

Respectfully submitted,

C. V. JONES & ARTHUR VANN

Attorneys for

GEORGE H. CARTER, JR.
formerly Trading as
DIXIE CONCRETE & SUPPLY COMPANY

DANIEL M. WILLIAMS, JR. and
J. L. ZIMMERMAN

Attorneys for

DURHAM LUMBER COMPANY

SEPTEMBER 1959.

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SUPREME COURT OF THE UNITED STATES

No. 23.—October Term, 1959.

United States of America, Petitioner, *v.* Durham Lumber Company, and George H. Carter, Jr.	On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

[June 20, 1960.]

Mr. Chief Justice Warren delivered the opinion of the Court.

This case involves the competing claims of the Federal Government and certain subcontractors to a sum of money owed to the taxpayers under a general construction contract.

The taxpayers, Michael & Embree, were general contractors doing business at Durham, North Carolina. Early in 1954, they agreed to construct certain buildings for persons herein referred to as the "owners." This work was completed on July 15, 1954, but because the owners disputed the amount due under the contract, payment to the taxpayers was delayed.

In completing the construction work, the taxpayers had utilized the services and materials of numerous subcontractors, most of whom had not been compensated. The respondents are two such subcontractors, who in January and February 1955, gave the owners notice of their respective claims against the taxpayers.

On January 18, 1955, the taxpayers were adjudicated bankrupts. At that time, there was an unpaid balance of $5,250 due from the owners under the construction contract. After extensive negotiations between the owners, the trustee in bankruptcy, and the subcontractors, it was agreed that the owners would absolve themselves

from further liability by paying the $5,250 to the trustee, and that the subcontractors could thereafter assert the same rights against the trustee as they could have asserted against the owner. This arrangement was approved by both the Superior Court for Durham County, North Carolina, and the federal bankruptcy court.

Another claimant of the money deposited with the trustee was the Federal Government, which on August 13, 1954, and November 22, 1954, had assessed the taxpayers for uncollected withholding and unemployment insurance taxes. By virtue of Sections 6321 [1] and 6322 [2] of the Internal Revenue Code of 1954, a federal tax lien attached to all "the property and rights to property" belonging to the taxpayers at the time the assessments were made. The Government contended that the money owing under the construction contract was property of the taxpayers to which the tax lien attached.

The Referee in bankruptcy, attempting to resolve the competing claims against the fund as if the parties were before a state court, decided that the rights of the Federal Government under its tax lien were superior to those of the respondents. The District Court for the Middle District of North Carolina disagreed, and held that the respondents were entitled to payment of their claims before the Government could satisfy its tax lien. On appeal, the

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[1] Section 6321. Lien for taxes:

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

[2] Section 6322. Period of lien:

"Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time."

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Court of Appeals for the Fourth Circuit affirmed, 257 F. 2d 570. We granted certiorari. 359 U. S. 905.

In affirming the judgment of the District Court, the Court of Appeals stated that the nature and extent of the general contractors' property rights, to which the tax lien attached, must be ascertained under state law. The court then undertook an extensive analysis of the relevant North Carolina statutes [3] and cases. It found that the North Carolina law provides as follows: Subcontractors who have not been paid by the general contractor have a direct, independent cause of action against the owner to the extent of any amount due under the general construction contract, and any money owed by the owner under the construction contract must first be used to satisfy subcontractors' claims of which the owner has notice. Moreover, to insure that the owner will receive notice of outstanding subcontractors' claims, the North Carolina statute, N. C. Gen. Stat., 1950, § 44–8, requires the general contractor, before receiving any payment, to furnish the owner with a statement of all sums due subcontractors, and if the general contractor fails to supply the required statement, he is guilty of a misdemeanor. N. C. Gen. Stat., 1950, § 44–12. Finally, the court found further evidence of the direct and independent nature of the subcontractors' claims against the owner in N. C. Gen. Stat., 1950, § 44–9, which provides that should the owner pay the general contractor after receiving notice of a subcontractor's claim, he will nevertheless be liable to the subcontractor to the extent of the amount which was due under the construction contract at the time notice was received.

Based upon these considerations, the Court of Appeals held that, under North Carolina law, the general contractor did not have a property interest in the face amount, as such, of the general construction contract.

[3] N. C. Gen. Stat., 1950, §§ 44–6 to 44–12.

Specifically, the court said that "except to the extent the claim of the general contractor exceeds the aggregate of the claims of the subcontractors, the general contractor has no right which is subject to seizure under the tax lien." *Id.*, at 574. Therefore, concluded the court, since under North Carolina law the taxpayers possessed merely a right to the residue of the fund, and since the Government's tax lien attached to the property interests of the taxpayers as defined by state law, the Government can recover only "so much of the construction price as will remain unpaid after the owners have deducted a sum sufficient to pay the subcontractors." *Id.*, at 575.

The Court of Appeals was correct in asserting that the Government's tax lien attached to the taxpayers' property interests in the fund as defined by North Carolina law. *Acquilino* v. *United States*, — U. S. —, —; [4] *Bess*

[4] This case points up the distinction we drew in *Aquilino*. The facts here show how it simply begs the question to suggest that the principle of the lien-priority cases is somehow subverted or evaded by recognizing that what constitutes the taxpayer's property in the first place is a question of state law. The facts show, too, that it does not promote clarity to substitute, for the property interests created by state law, a rule of federal property law, the main feature of which seems to be an inquiry into what the consequences would be if state law were different from what it in fact is. It is said that we should regard the subcontractor's interest as equivalent to a lien on the general contractor's claim against the owner, overlooking the fact that the law of North Carolina, as interpreted by the Court of Appeals, indicates that there is no such claim. If we are to equate the subcontractor's interest with something it is not, it would be much more appropriate, in terms of similarity, to equate it with the usual mechanic's lien of a subcontractor on the owner's property being improved—which of course is not the general contractor's property, and which could not be taken by the United States under a lien against the general contractor. This only points up the lack of precision and content in the proposed federal definition of property. See also *Fidelity & Deposit Co. of Md.* v. *New York City Housing Auth.*, 241 F. 2d 142 (C. A. 2d Cir.), cited with approval in *Bess* v. *United States*, 357 U. S. 51, 55.

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v. *United States*, 357 U. S. 51, 55; cf. *Morgan* v. *Commissioner*, 309 U. S. 78, 82. It is suggested that the courts of North Carolina have never specifically described the nature of the property rights created by the North Carolina statutes involved in this case, and that the Court of Appeals' interpretation of those statutes is probably incorrect. However, where "the precise issue of state law involved . . . is one which has not been decided by the . . . [state] courts," this Court has said that, "in dealing with issues of state law that enter into judgments of federal courts, we are hesitant to overrule decisions by federal courts skilled in the law of particular states unless their conclusions are shown to be unreasonable." *Propper* v. *Clark*, 337 U. S. 472, 486–487. Since the Court of Appeals is much closer to North Carolina law than we are, and since we cannot say that the court's characterization of the taxpayers' property interests under that law is clearly erroneous or unreasonable,[5] the judgment is

Affirmed.

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[5] See *Sims* v. *United States*, 359 U. S. 108, 114; *Ragan* v. *Merchants Transfer & Warehouse Co.*, 337 U. S. 530, 534; *Estate of Speigel* v. *Commissioner*, 335 U. S. 701, 707–708.

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SUPREME COURT OF THE UNITED STATES

Nos. 1 and 23.—October Term, 1959.

Robert Aquilino and Joseph Spero, d/b/a Home Maintenance Company, and Colonial Sand and Stone Co., Inc., Petitioners, v. United States of America, Ada Bottone, et al.	On Writ of Certiorari to the Court of Appeals of the State of New York.
United States of America, Petitioner, v. Durham Lumber Company, and George H. Carter, Jr.	On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

[June 20, 1960.]

Mr. Justice Harlan, dissenting in Nos. 1 and 23.

I am unable to subscribe to the reasoning which underlies the Court's disposition of these cases. By holding that they both turn on whether the taxpayer had "property" under state law to which the Government's lien could attach, the Court has sanctioned a result consistently prohibited by us in a line of cases dealing with the priority of federal tax liens.[1]

[1] *United States* v. *Security Trust & Savings Bank*, 340 U. S. 47 (1950); *United States* v. *City of New Britain*, 347 U. S. 81 (1954); *United States* v. *Acri*, 348 U. S. 211 (1955); *United States* v. *Liverpool & London Globe Ins. Co., Ltd.*, 348 U. S. 215 (1955); *United States* v. *Scovil*, 348 U. S. 218 (1955); *United States* v. *Colotta*, 350 U. S. 808 (1955); *United States* v. *White Bear Brewing Co.*, 350 U. S. 1010 (1956); *United States* v. *Vorreiter*, 355 U. S. 15 (1957); *United States* v. *Ball Construction Co., Inc.*, 355 U. S. 587 (1958); *United States* v. *Hulley*, 358 U. S. 66 (1958).

In both cases, the delinquent taxpayer is a defaulting general contractor whose subcontractors remain unpaid. The Government's lien is asserted against the chose in action which the general contractor allegedly holds against the owner of the real estate on which the improvements were made, in respect of amounts due from the owner under the construction contract. If the subcontractors had sought to enforce their claims by imposing a lien on that chose in action, there is no question that the Government's lien would prevail. Under the decisions of this Court cited in note 1, *supra*, a federal tax lien asserted against a taxpayer's property under §§ 3670 and 3671 of the Internal Revenue Code of 1939 [2] prevails over all other claims against such property except (1) those which attach and become "choate" before the federal lien attaches, and (2) those specifically protected by § 3672 (a).[3] It is conceded that the interests of the subcontractors in the present cases are not protected by § 3672 (a) and would not be considered choate under the applicable decisions. See *United States* v. *Kings County Iron Works*, 224 F. 2d 232 (C. A. 2d Cir. 1955).

The Court believes, however, that the present cases are different, because under state law, the general contractor in *Aquilino* held his claim against the owner in trust for the subcontractors to the extent of their claims, and because the subcontractors in *Durham Lumber* were given, to the extent of their claims, a direct right of action

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[2] The text of these sections, applicable in the *Aquilino* case, are set forth in note 1 of the Court's opinion in No. 1, *ante*, —. The comparable provisions of the Internal Revenue Code of 1954, §§ 6321 and 6322, applicable in the *Durham Lumber* case, are printed in notes 1 and 2 of the Court's opinion in No. 23, *ante*, —.

[3] That section provides: "Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector . . . ." The comparable provision of the Internal Revenue Code of 1954 is § 6323 (a).

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against the owner in respect of his debt to the general contractor, and that in these circumstances the rights of the subcontractors in the owner's debt are superior to those of the general contractor. It is said that, to the extent of the subcontractors' claims, the general contractor, under state law, thus had no "property" interest in the amounts due him from the owner, and that under the principles enunciated in *United States* v. *Bess*, 357 U. S. 51, a federal tax lien can attach only to a property interest which exists under state law.

I cannot see how it makes any difference, for purposes of the federal tax-lien statute, whether state law purports to prefer subcontractors over the general contractor and parties claiming through him by giving the subcontractors a lien on the general contractor's right of action against the owner or by giving them a prior right to collect the debt itself. In both instances, the owner is under a contractual duty to pay the general contractor and the latter is under a contractual duty to pay the subcontractors. In both instances, the subcontractors are attempting to satisfy their claims against the general contractor. And in both instances, they are seeking to satisfy themselves by claiming precisely the same thing—a prior right in the proceeds of the debt which arises by virtue of the contractual relationship between the owner and the general contractor.[4] In neither instance can the subcontractors

[4] It is noteworthy that the North Carolina law involved in the *Durham Lumber* case requires the general contractor to furnish the owner with a statement of subcontractors' claims "before receiving any part of the *contract price, as it may become due*," and that it is thereafter the duty of the owner to retain an appropriate amount "from the money *then due the contractor*." N. C. Gen. Stat., 1950, § 44–8. (Emphasis added.) Although this section indicates that the general contractor has no right to collect the proceeds of the main contract until the statutory conditions are satisfied, it obviously recognizes the owner's contractual obligation as the real basis of the

collect more than that to which the subcontract entitles them, and in neither can the owner be required to pay more than that to which the main contract obligates him. If federal law requires that subordination of the general contractor's interest be ignored in the one instance, it does so equally in the other.

The *Bess* case does not require a contrary conclusion. That case held only that while a federal tax lien attached to the cash surrender value of a life insurance policy owned by the taxpayer, it did not attach to the proceeds paid on his death, because under state law he had no right to such proceeds during his life. There was no reason under those circumstances why state property concepts should not control. To read that case as standing for the proposition that such concepts must also be controlling in cases such as these defeats the rule that "the relative priority of the lien of the United States for unpaid taxes is . . . always a federal question to be determined finally by the federal courts." *United States* v. *Acri*, 348 U. S. 211, 213. It is one thing to say, as the Court did in *Bess*, that the federal interest in uniform application of federal tax liens does not require, as a general rule, that state property concepts be disregarded. It is quite another to permit such concepts to control the extent of a federal lien's application in situations indistinguishable from those where the Court has in fact, rightly or wrongly, enforced a uniform federal rule. Given federal supremacy in this field, it surely cannot be that the federal courts may not appraise for themselves the true impact of state-created rights upon the priority of federal tax liens within the criteria established by this Court. Cf. *Carpenter* v. *Shaw*, 280 U. S. 363, 367; *City*

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transaction and the source of the subcontractors' rights. The subcontractors' claims are thus not akin to liens on the owner's real estate, as this Court suggests, but are asserted solely in respect of the monetary claim held by the general contractor against the owner.

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of Detroit v. *Murray Corporation*, 355 U. S. 489, 492. To recognize the substantial equivalence of the situations is not to create a new rule of federal property law but to require an evenhanded application of an already established one. It seems to me that Judge Fuld of the New York Court of Appeals was quite right in holding in the *Aquilino* case that New York could not, consistently with the past decisions of our Court, defeat the otherwise superior federal lien upon the owner's debt to the general contractor by converting the debt into a trust for the benefit of the subcontractor.[5]

To read *Bess* as the Court does can only lead to confusion in the administration of the federal tax-lien statute. A taxpayer's property in a debt is surely diminished by the imposition of a lien on his interest, for he has no right to collect the liened portion nor to alienate it. Yet in precisely this situation, we have held that the federal tax lien is not affected by such diminution. *United States* v. *Liverpool & London Globe Ins. Co., Ltd.*, 348 U. S. 215. If this holding is to be preserved after today's decision, subsequent cases must turn on the elusive distinction between diminishing a greater property interest and

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[5] "It is, by now, exceedingly well settled that no state-created rule may defeat the paramount right of the United States to levy and collect taxes uniformly throughout the land. (See United States v. Vorreiter, 355 U. S. 15, revg. 134 Col. 543; United States v. White Bear Brewing Co., 350 U. S. 1010, revg. 227 F. 2d 359; United States v. Colotta, supra, 350 U. S. 808, revg. 224 Miss. 33; United States v. Scovil, supra, 348 U. S. 218, 220-221; United States v. New Britain, supra, 347 U. S. 81, 84-87; United States v. Kings County Iron Works, supra, 224 F. 2d 232, 237). That being so, it follows that the provision in this state's Lien Law, to which respondents point—that funds received by a contractor from the owner for the improvement of real property shall be deemed 'trust funds' for the payment of subcontractors (§ 36-a; § 13, subd. [7])—may not be construed to affect the rights of the government or the priority of its tax lien." 3 N. Y. 2d, at 516, 146 N. E. 2d, at 777-778.

initially conferring a lesser one.[6] The very difficulty which this Court experiences in trying to determine whether under New York law the general contractor really holds only a bare legal title in trust for the subcontractors or has full ownership of the debt subject to a lien in favor of the subcontractors demonstrates the futility of attempting to draw such distinctions for federal purposes. I venture to suggest that on remand, the Court of Appeals can with equal facility label the subcontractors' interests "property" or a "lien," the relevant incidents of the relationship being the same in either case. Why should not that court, and the legislatures of other States readily respond in choosing the former alternative?

I would affirm the judgment in No. 1, and would reverse in No. 23 on the ground that North Carolina can under no circumstances accord subcontractors a right in the proceeds of the debt arising from the construction contract superior to the Government's lien without satisfying one of the two requirements laid down by federal law. If the

[6] It will not do to distinguish the present type of case from the lien-priority cases on the ground that in the latter cases the taxpayer remains the owner in a very real sense and can continue to enjoy the property if he discharges the debt it secures. In both instances, the taxpayer is temporarily deprived of certain incidents of ownership as a device for securing the payment of a debt, and is restored to the full enjoyment of the property only when the debt is discharged. And it is illusory to say that ownership of a debt which can be neither collected nor alienated is any more "real" than the ownership of no debt at all. Whether the diminution of the taxpayer's interest is sufficiently definite and complete to conclude the federal lien is precisely the question on which this Court has held federal law must control. It is admitted that, if the federal standard of "choateness" developed by this Court in the lien-priority cases is applied, the incidents of ownership retained by the taxpayers here must in fact be deemed greater than those retained by taxpayers in cases where state-created liens imposed on their interests have prevailed over the Government's lien.

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federal standard of choateness is thought to be an undesirable restriction on the States' freedom to regulate property relationships, the cases establishing that standard should be expressly overruled and not emasculated by dubious distinctions.

MR. JUSTICE BLACK, while adhering to the dissenting views expressed by him in *Commissioner* v. *Stern*, 357 U. S. 39, 47, and *United States* v. *Bess*, 357 U. S. 51, 59, concurs in this opinion.